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No. 84-10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

CITIES OF BETHANY, BUSHNELL, ILLINOIS, *ET AL.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Whether this Court's *Sierra-Mobile* doctrine[1] applies to protect contracts between Cities and a public utility which expressly require that any change in rate be "subject to the approval of the regulatory body" so as to preclude unilateral rate increases by the utility from becoming effective prior to approval of such increases on their merits by the Federal Energy Regulatory Commission under §206 (a) of the Federal Power Act.

2. Whether the making of *de novo* findings of fact by the court below in reviewing an agency order, which are inconsistent with the factual findings by the agency, exceeded the reviewing authority of the court and deprived the Cities of a fair hearing on the issues.

PARTIES BELOW

Federal Energy Regulatory Commission ("FERC")
Central Illinois Public Service Company ("CIPS")
Illinois Cooperative Group ("Co-ops")
Illinois Cities of Bethany, Bushnell, Cairo, Carmi, Casey, Flora, Greenup, Marshall, Metropolis, Newton, Rantoul, and Roodhouse ("Cities" or "Municipalities")

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[1]United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956); FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956).

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CITIES OF BETHANY, BUSHNELL, ILLINOIS, *ET AL.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Illinois Cities ("Cities" or "Municipalities"), respectfully petition for a *writ of certiorari* to review the February 7, 1984 decision of the United States Court of Appeals for the District of Columbia Circuit in *Cities of Bethany, Bushnell, Illinois, et al., v. Federal Energy Regulatory Commission,* 727 F.2d 1131 (D.C. Cir. 1984), App. 41a. Petitioners seek reversal of that part of the court's decision specified herein relating to a denial of their contract rights under the *Sierra-Mobile* doctrine.

The challenged actions of the court below reversed in part Opinion Nos. 142 and 142-A of the Federal Energy Regulatory Commission, 20 F.E.R.C. (CCH) ¶ 61,043 (1982) and 20 F.E.R.C. (CCH) ¶ 61,435 (1982).

OPINIONS AND ORDERS BELOW

The decision and order of the United States Court of Appeals for the District of Columbia Circuit reversing the Federal Energy Regulatory Commission's Opinion Nos. 142 and 142-A in the FERC Docket No. ER80-71-000 is reported at 727 F.2d 1131 and is reprinted in the Appendix. The Commission's Orders are reported at 20 F.E.R.C. (CCH) ¶ 61,043 (1982) and at 20 F.E.R.C. (CCH) ¶ 61,435 (1982) and are set forth in the Appendix.

JURISDICTION

The decision of the United States Court of Appeals for the District of Columbia Circuit was entered on February 7, 1984 (App. 41a). On April 6, 1984, the Court of Appeals denied petitioners' motion for rehearing with the suggestion for rehearing en banc (App. 71a). This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

The statute upon which the Court of Appeals' decision is based is the Federal Power Act, 16 U.S.C. §824 *et seq.*

STATEMENT OF THE CASE

Central Illinois Public Service Company ("CIPS" or "Company") sells electricity at wholesale (for resale to ultimate customers), in the State of Illinois. Its wholesale

rates are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC" or "Commission") under the Federal Power Act, 16 U.S.C. §824 *et seq.* Petitioners, Casey, Flora, Greenup and Newton, Illinois entered into twenty-year contracts with CIPS in 1965 for all requirements wholesale service. The contracts contained a designated rate and provided as follows:

> The term of this agreement shall be for a period of 20 years from and after the effective date hereunder; provided, however, that the rates and charges for service hereinbefore set forth shall apply only during the first ten years of the period, and *rates and charges for the second ten years of the period shall be mutually agreed to by both parties subject to the approval of the regulatory body or bodies as may have jurisdiction thereof.* (Emphasis added).[1]

At the end of the first ten-year period in 1975, CIPS made no attempt to negotiate with the Municipalities to obtain mutual agreement for any increase in designated rates and charges to apply for the second ten-year period of their contract. Instead, CIPS made a unilateral rate increase filing at the Federal Power Commission[2] and wrote a letter to the attorneys of each of the four Cities advising them as follows:

> The rates and charges for service provided in the Agreements between the City of Newton and Central Illinois Public Service Company dated March 2, 1965 for the purchase of electric power by the City expired on May 20, 1975.

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[1]Opinion No. 141 at 13; R. 2778.

[2]The Federal Energy Regulatory Commission replaced and succeeded to the responsibilities of the Federal Power Commission under the Federal Power Act by virtue of 42 U.S.C. § 7172(a) (Supp. V 1981).

> The Federal Power Commission has accepted for filing, to become effective June 1, 1975, our proposed Rate Schedule W-2 for Wholesale Electric Service to Municipalities. We, therefore, will apply Rate Schedule W-2 to service provided to the City on and after June 1, 1975 under the above agreement. Attached for your information is a copy of Rate Schedule W-2.

Based on this representation from the Company, the Cities believed that the Federal Power Commission had approved the rate increases so that no further objection was possible.[3]

Subsequently, still during the second ten-year period, CIPS, on November 2, 1979, unilaterally filed a massive new 35% rate increase against the Municipalities at the Federal Energy Regulatory Commission ("FERC"), designated as FERC Docket ER80-71, without seeking or obtaining the mutual consent of the four municipalities.[4] The FERC suspended the rate increase filing until May 10, 1980, permitting it to become effective on that date, subject to refund, and ordered hearings to determine if the rate was just and reasonable. The Cities filed a motion to reject the rate increase as contrary to the terms of their outstanding contracts as protected by the doctrine known as the *Sierra-Mobile* doctrine, established by landmark decisions of this Court in *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), and *United States Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956). Under that doctrine, unless authorized by the language of the contract, a unilateral rate increase under §205 of the

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[3]R. 2937. Similar letters were sent to the other three Cities, *e.g.*, R. 2934.

Federal Power Act[5] cannot be made, but rate increase filings are treated under § 206 of the Act,[6], requiring prospective effectiveness of a rate change only *after* an order of the Commission *approving* the increase on its merits.

The Federal Energy Regulatory Commission granted the Municipalities' motion to reject the Company's unilateral rate increase filing under §205 of the Federal Power Act, in its Opinion No. 142, issued July 12, 1982, as contrary to the *Sierra-Mobile* doctrine. The Commission noted that CIPS conceded that it had not complied with the language of the contracts to obtain an increased rate and denied the Company's contention that the Cities had acquiesced in CIPS's successive rate filings with the Commission after 1975:

> In its response to the motion of Flora and Greenup, CIPSCO does not dispute the fact that the terms of the contracts have not been complied with. Instead, it relies on the fact that subsequent to the expiration of the first 10 year term in 1975, the cities have acquiesced in CIPSCO's successive rate filings with this Commission. CIPSCO argues that this acquiescence amounts to subsequent conduct having the effect of modifying the contract and that "it is simply too late for Cities to now protest that they are secure in their contracts and cannot be held to the terms of their tacit agreement to substitute Commission rate making for the unworkable and outdated provision in their 1965 contracts." (CIPSCO answer, p. 8).
>
> CIPSCO's argument is not persuasive. Similar arguments were considered and rejected in a re-

[5] 16 U.S.C. § 824d(a), (d) and (e) (1982).
[6] 16 U.S.C. § 824e(a) (1982).

> cent case involving *Utah Power and Light Company,* Opinion No. 113, issued on February 23, 1981 [14 FERC ¶ 61,162]. *See also Louisiana Power & Light Company v. F.E.R.C.,* 587 F.2d 671 (5th Cir. 1979). It is more reasonable to conclude that the cities by their actions have previously waived their right to assert the contract defense but that they have not modified the contracts and remain free to assert their previously waived rights if they so choose.[7]

The Commission's decision was consistent with a long-standing administrative construction based on many judicial decisions of the Courts of Appeals of similar contract language. The FERC ordered CIPS to refund with interest to the Cities the increased rates collected in the docket since the date the unilateral filing became effective on May 10, 1980 through the date of its opinion on July 12, 1982, wherein the Commission approved a "just and reasonable" rate for the future.[8]

CIPS appealed the FERC's decision on the *Sierra-Mobile* issue to the United States Court of Appeals for the District of Columbia Circuit.

On February 7, 1984, the court below, in a decision by Judge Wilkey joined by Judges Wald and MacKinnon, reversed the Commission's decision and held that the Cities' contracts with CIPS were not entitled to protection under the *Sierra-Mobile* doctrine so that the Company was free to make §205 unilateral rate increase filings at any time during the second ten-year term of the contract. The court ruled that the language of the contract permitted §205 filings:

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[7]20 F.E.R.C. at 61,090; R. 2779, App. 21a-22a

[8]The Company refunded approximately $2,500,000 to the four cities.

> Furthermore, the language in the contract providing that rates shall be agreed upon by the parties "subject to the approval of the regulatory body" is also consistent with section 205 filings. FERC's authority under section 205 to suspend and investigate rates filed under section 205 has been interpreted as the authority to "approve" rates.[59] Furthermore, FERC's tendency in recent years to require an explicit expression in private contracts of the parties' intention to permit unilateral filings under section 205 is not highly relevant to the meaning of a provision executed in 1965.[60]
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> [59]*See City of Piqua, Ohio v. FERC*, 610 F.2d 950 (D.C. Cir. 1979).
>
> [60]*See*, e.g., *Public Service Co. of New Mexico v. FERC*, 628 F.2d 1267, 1270 (10th Cir. 1980), *cert. denied*, 451 U.S. 907 (1981).

The court also made a finding directly contrary to the finding by the FERC that the course of conduct under the contract since 1975 did not constitute a waiver or bar the Cities from enforcing their clear contract rights under the *Sierra-Mobile* doctrine. The court made a *de novo* finding of fact that the failure of the Cities to object to the unilateral increases by CIPS since 1975 up to the rate increase filed in 1979 in the present case, should be used as a basis for construing the contract as not protected by the *Sierra-Mobile* doctrine. App. 66a-67a. Not only was this contrary to the FERC's finding relating to the course of conduct, but deprived the Cities of their right to a hearing on the factual issue as to whether they had been misled by CIPS's representations in 1975, when the first ten years ended, that the Federal Power Commission had authorized CIPS's unilateral rate increase to be effective.

BASIS FOR GRANTING WRIT

Petitioners respectfully request issuance of a *writ of certiorari* in order to rectify a very damaging and incorrect interpretation by the court below of this Court's *Sierra-Mobile* doctrine. In overturning the unanimous FERC's construction of the *Sierra-Mobile* doctrine on the basis of the contract, the court below completely oveturned a long-standing construction of contract language under the *Sierra-Mobile* doctrine which directly conflicts with decisions of the Second, Fifth and Tenth Circuit Courts of Appeals, as well as three prior decisions of the D.C. Circuit.

In addition, the decision of the court below in making a *de novo* finding of fact relating to the course of conduct under the contract, contrary to factual matters decided by the agency, without a remand, has departed from long-standing principles governing judicial review of agency action.

I. THE COURT OF APPEALS' REVERSAL OF THE FEDERAL ENERGY REGULATORY COMMISSION'S INTERPRETATION OF THE UTILITY SERVICE CONTRACTS CONFLICTS DIRECTLY WITH HOLDINGS OF OTHER CIRCUITS AS WELL AS PRIOR DECISIONS BY THAT SAME COURT.

The twenty contracts at issue were executed in 1965 by the four Illinois cities and CIPS.[9] This was nine years after the landmark decision by this Court in the *Sierra*[10] and *Mobile*[11] cases. Those cases, as well as the companion *Memphis*[12] case, made it quite clear that if a public utility

[9]At the time the contracts were entered, utility costs and rates were decreasing due to the efficiencies gained from larger generating units. National Power Survey.

[10]350 U.S. 348.

[11]350 U.S. 322.

[12]United Gas Pipe Line Co. v. Memphis Light, Gas & Water Division, 358 U.S. 103 (1958).

sought to reserve the right to make unilateral rate increase filings under a contract, it had to do so expressly. Under the terms of the contracts involved in this case, specific, identified rates were made applicable for the operation of the contract for the first ten years. For the second ten-year term of the contract, the contracts expressly provided as follows:

> The term of this agreement shall be for a period of 20 years from and after the effective date hereunder; provided, however, that the rates and charges for service hereinbefore set forth shall apply only during the first ten years of the period, and *the rates and charges for the second ten years of the period shall be mutually agreed to by both parties subject to the approval of the regulatory body or bodies as may have jurisdiction thereof.* (Emphasis added).

The FERC found, based on its long experience with *Sierra-Mobile* type contracts, that such language refers to a final Commission approval of any proposed rate increase, which can occur only under Section 206(a) of the Federal Power Act, on a prospective basis. App. 24a.

The court below in reversing the unanimous Commission simply ignored a long line of judicial decisions, construing language similar to that of the Cities' contracts requiring "approval of the regulatory body" as requiring an order under §206(a), necessitating approval of the increase on its merits before it could become effective. The court held that the contract language would allow a unilateral rate filing under §205 by CIPS and a rate to become effective against the Cities before any approval by the FERC of the justness and reasonableness of the proposed increase on the merits. The decision by the court below directly conflicts with decisions interpreting similar contract

language by the Second, Fifth, and Tenth Circuits as well as three prior decisions of the D.C. Circuit itself. In so doing, the court clearly has deviated from this Court's original pronouncements of *Sierra-Mobile*, and *certiorari* should be granted to clarify this important issue of federal law.

Under the *Sierra-Mobile* doctrine, the contracting parties exclusively determine their rate relationships and how, if at all, such rates might be altered.[13] If the agreement contemplates a unilateral rate filing under Section 205 of the Federal Power Act, where a rate change is effected solely at the discretion of the filing utility and which does *not* result from FERC approval, *Sierra-Mobile* requires express reservation of that right by the filing utility.[14] Yet,

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[13]Subject to agency review to ensure that the arrangements are not contrary to the public interest. *Sierra*, 350 U.S. at 354, 355.

[14]As noted by the Tenth Circuit in Public Service Co. of New Mexico v. FERC, 557 F.2d 227, 232 (10th Cir. 1977), respecting a contract executed in the 1960s:

> We feel the parties would not have left the reservation of an important right such as the making of unilateral rate changes to implication from provisions like those of Article XII, or of Article II, but would have clearly provided for such filings if they had been intended.

The subject was previously addressed by the Supreme Court in United Gas Pipe Line Co. v. Memphis Light Gas & Water Div., 358 U.S. 103 (1958), permitting unilateral increases only when expressly reserved by explicit contract language. Nothing in the Cities' contracts drafted by CIPS and executed in 1965, shortly after *Memphis*, resemble in any way the express language of the *Memphis* contract permitting unilateral filings. CIPS could have used the *Memphis* language in drafting the Cities' contracts, but did not do so. *See* Public Service Co. of Indiana v. FERC, 575 F.2d 1204, 1210 (7th Cir. 1978).

in this case, no such reservation existed. This is plainly evident from the contract. The only reference in the contract provision is "subject to the approval" of the applicable regulatory agency,[15] which is a succinct refutation of the lower court's interpretation of the contractual language.

The decision of the court below directly conflicts with decisions of other Circuit Courts of Appeals, construing this Court's *Sierra-Mobile* doctrine. In *New York State Elect. & Gas Corp. v. FERC,* 712 F.2d 762, 768 (2d Cir. 1983), the contract provided that "Power Authority shall compensate NYSEG . . ., at such rates as shall be approved by FERC[.]" The Second Circuit upheld the FERC's construction of the language as requiring a final approval on the merits under Section 206 of the Federal Power Act:

> We find FERC's interpretation to be more persuasive. The phrase 'as shall be approved by FERC' appears to refer to the final approval process prescribed in 16 U.S.C. §§824d, 824e. Approval is a term of art which has been construed in the past by FERC's predecessor, the Federal Power Commission, to connote final as opposed to initial acceptance. For instance, in *Appalachian Power Co.,* 56 F.P.C. 2902 (1976),

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[15] "Approval" of rates only can be accomplished by final Commission order changing rates. Thus, contracts including language similar to the last phrase in Cities' contracts have been found to provide for a rate change effective on a prospective basis only from such final order. Missouri Power & Light Co., 55 F.P.C. 2693 (1976), *aff'd sub nom. without opinion,* Marceline v. FERC, N. 79-1740 (D.C. Cir. June 21, 1980) ("[R]ates may be changed during the term of the contract, but only with the approval of the appropriate regulatory agency."); Detroit Edison Co., 54 F.P.C. 12 (1975) (Customers shall pay for service "under the terms and conditions of Company's applicable Rate Schedule on file and approved by the Federal Power Commission.")

> *order on reh'g,* 57 F.P.C. 1140 (1977), the pertinent clause of the contract provided that 'any party may at any time . . . unilaterally take any action . . . that it deems desirable and in such event the terms and conditions under which service shall be rendered hereunder shall be the terms and conditions authorized by such authority.' The FPC interpreted 'authorized' just as it previously had interpreted 'approved' — neither permitted 'unilateral filing under Section 205 of the Federal Power Act.' The utility could propose rate changes under the modified *Mobile-Sierra* contract, but the new rate could not go into effect prior to receiving ultimate approval from the Commission.

712 F.2d at 768, (emphasis added; footnote omitted). In *Louisiana Power & Light Co. v. FERC,* 587 F.2d 671 (5th Cir. 1979), the Fifth Circuit affirmed a FERC decision where the quoted language was found to contemplate Section 206 only:

> The terms and conditions of the Agreement and Rate Schedules *are subject to approval or acceptance for filing by any governmental regulatory authority hereof and to amendment or alteration as a result of and in accordance with a valid applicable order of any such governmental regulatory authority.*

Id. at 675 (emphasis by the court). And in *Public Service Co. of New Mexico v. FPC,* 557 F.2d 227, 231-232 (10th Cir. 1977), the Tenth Circuit affirmed the Federal Power Commission's decision that the following contract language required a final approval by the Commission under Section 206:

> This contract, including the tariff made a part

> hereof, shall at all times be subject to such changes or modifications as shall be ordered from time to time by any legally constituted regulatory body having jurisdiction to require such changes or modifications.

New Mexico, 557 F.2d at 231, n.10.[16]

The decision below also directly conflicts with the lower court's own prior decisions. In *City of Oglesby v. FERC,* 610 F.2d 897, 909-910 (D.C. Cir. 1979), the court held that a contract, providing that a rate could be changed only "by order" of the regulatory authority, requires final *approval*[17] by the Commission under Section 206:

> *[t]he Supreme Court informs us that a rate change pursuant to Section 205 occurs 'not by an order of the Commission but solely by virtue of the . . . company's own action.'*[91] *And as the involved agency itself has explained, 'an order by this Commission accepting for filing a rate increase filed pursuant to Section 205 is not an ap-*

[16]This holding was reaffirmed in Public Service Co. of New Mexico v. FERC, 628 F.2d 1267, 1270 (10th Cir. 1980), *cert. denied,* 451 U.S. 907 (1981).

[17]In fact, CIPS never even sought to negotiate to obtain the agreement of the Cities before filing for an increase. The first condition of the contract was never satisfied. Under Missouri Utilities Company, FPC Docket No. ER77-354, issued June 1, 1977, such contractual provisions must be satisfied as a condition precedent before a utility's filing can merely be accepted. No Section 205 or 206 investigation can initiate until such satisfaction.

In Kansas Gas & Electric Co., 2 F.E.R.C. (CCH), ¶ 61,095 (1978), Fed. Reg. 5042, 5044, the Commission interpreted Article IX of the Iola contract, which was silent as to future rate changes, "to provide that the rate may be changed either after a negotiated agreement or after binding arbitration." Since neither event had occurred, the Commission instituted Section 206 proceedings applying the *Sierra-Mobile* burden of proof rather than the just and reasonable standard.

> *proval of such an increase by this Commission.*"[92] Consequently, action under Section 205 indulging temporary collection of a higher rate preliminary to an administrative determination that the increase is warranted does not constitute an agency 'order' affirmatively setting the new rate.

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[91] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, *supra* note 8, 350 U.S. at 342, 76 S.Ct. at 380, 100 L.Ed. at 385. *See also* note 90 *supra*.

[92] *Indiana & Mich. Elec. Co.*, *supra* note 66, 51 F.P.C. at 1754, quoted in text *supra* at note 70.

Oglesby, 610 F.2d at 910 (emphasis added).

The use of the word "approved" in the contracts in the present case thus is a stronger authority for Section 206 treatment than the City contracts in *Oglesby* using the word "order." In *Papago Tribal Utility Authority v. FERC*, 610 F.2d 914, 925-926 (1979), the court reviewed Commission precedents on the issue and concluded that contract language providing change "subject to the approval of government regulatory bodies having jurisdiction" was consistent with Section 206 only. In *Kansas Cities v. FERC*, 723 F.2d 82, 91-92 (D.C. Cir. 1983), the court sustained the Commission's conclusion that the following language required a Section 206 just and reasonable finding:

> This Agreement and all obligations hereunder are subordinate to, subject to and conditioned upon the valid orders (including but not necessarily limited to orders fixing or approving rates and/or standards and conditions of service) of, and the granting of approval and authorization by any Commission or other regulatory body having rate making and/or other jurisdiction or

whose authorization may be required by law including any judicial review thereof.

Kansas Cities, 723 F.2d at 87.

The finding by the court below, aside from creating conflicts in established law, totally upsets the underlying fabric of the *Sierra-Mobile* precepts. The contract does not provide for a unilateral right for CIPS to effect a rate change without FERC approval – the court's decision below disrupts almost 30 years of precedents, since the *Sierra* and *Mobile* cases were adjudicated in 1956, warranting review by this Court on *certiorari.*

II. THE COURT BELOW ERRED IN MAKING *DE NOVO* FINDINGS OF FACT ON HIGHLY CONTESTED ISSUES CONTRARY TO THE COMMISSION'S FINDINGS OF FACT WITHOUT A REMAND TO THE COMMISSION.

It is the general rule in contract litigation that questions of law may be reviewed *de novo* by an appellate court but that questions of fact are for the trier of fact. J. Calamari & J. Perillo, *Contracts* 124 (1977); 3 Corbin, *Contracts,* §554 (1963); Restatement (Second) of Contracts §238 (1977). This means where extrinsic evidence outside the language of the contract is considered, the interpretation of the trier of fact is conclusive on appeal, unless the meaning is so clear that reasonable minds could not possibly make that interpretation. *Id.* That standard of review – that the finding is conclusive on appeal unless reasonable minds could not have reached that conclusion from the facts of the case – is essentially the same as a court's review of administrative findings under the substantial evidence test. *Consolo v. Federal Maritime Commission,* 383 U.S. 607, 619-620 (1966); *NLRB v. Columbia Enameling & Stamping Co.,* 306 U.S. 292, 300 (1939);

Consolidated Edison Co. v. NLRB, 305 U.S. 197, 229 (1938).

However, the decision by the court below is irreconcilably inconsistent with this law. The court below not only gave no deference at all to the Commission's findings, but offered its own conflicting *de novo* findings of fact regarding the parties' course of conduct under the contract. The court found that absence of objection by the Cities to an earlier rate filing is evidence of an intent that may be used to construe the express language of the contract contrary to its plain meaning under the *Sierra-Mobile* doctrine. The Commission had expressly refused to make such a finding of fact urged on it by CIPS.[18] The Cities contended further that CIPS's contention, if somehow relevant, posed serious disputed factual issues based on CIPS's representation to the Cities in 1975 when the first ten years of the contract expired. At that time, CIPS sought no negotiations with the Cities and advised them that the Federal

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[18]The Commission stated:

> "CIPSCO's argument is not persuasive. Similar arguments were considered and rejected in a recent case involving *Utah Power & Light Company*, Opinion No. 113, issued on February 23, 1981 [14 F.E.R.C. ¶ 61,162]. *See also Louisiana Power & Light Co. v. FERC*, 587 F.2d 671 (5th Cir. 1979). *It is more reasonable to conclude that the cities by their actions have previously waived their right to assert the contract defense but that they have not modified the contracts and remain free to assert their previously waived rights if they so choose.*
>
> Nor have the cities waived their right to assert a contract defense in this case. . . . It appears that a hearing would have been required in any event to resolve the issues contested by other cities. Consequently CIPSCo's waiver argument is rejected."

20 F.E.R.C. ¶ 61,043 at 61,090-61,091 (emphasis added). App. 21a-22a.

Power Commission had already accepted the Company's unilateral rate increase filing. R. 2947. The Commission held no hearing and made no factual findings on this disputed issue of fact in view of its finding that the Cities had not waived their *Sierra-Mobile* rights. The *de novo* finding of fact by the court below to the contrary, without any evidentiary hearing, was clear error.

The inappropriateness of the judicial review standard for agency findings employed by the court below, based on precedents of this Court, is well summarized by the case of *United States v. Cheramie Bo-Truc #5, Inc.*, 538 F.2d 696, 699 (5th Cir. 1976):

> [T]he judicial review available in any case reviewed on the record of an agency hearing provided by statute is not *de novo;* it is limited to determining whether the agency's findings are supported by substantial evidence. 5 U.S.C. §706(2)(E) (1970). The APA [Administrative Procedure Act] provides that reviewing courts should invalidate any findings 'unwarranted by the facts to the extent that the facts are subject to trial *de novo.' Id.* §706(2)(F). Relying on the House hearings explaining this section, the Supreme Court in *Citizens to Preserve Overton Park, Inc. v. Volpe,* 401 U.S. 402, 415, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971), pointed out that trial *de novo* is only appropriate in only two situations, the only relevant one here being when agency fact finding procedures in an adjudicatory proceeding are inadequate. *See also Camp v. Pitts,* 411 U.S. 138, 141-42, 93 S.Ct. 1241, 36 L.Ed.2d 106 (1973) (per curiam). The House hearings relied on by the *Overton Park* Court make clear that *de novo* review is not available

> when the relevant statute requires that an order be issued only after an administrative hearing.

Again, as noted by the Fifth Circuit, *de novo* findings of fact by the appellate court reviewing agency findings of fact are not proper:

> Although factual issues remain to be resolved, however, these questions may not be decided *de novo* by the district court. *De novo* determination of a factual question in a judicial review of an adjudicatory proceeding governed by the Administrative Procedure Act is authorized only if the agency factfinding procedures are inadequate. *Camp v. Pitts,* 411 U.S. 138, 141-42, 93 S.Ct. 1241, 1243, 36 L.Ed.2d 106 (1973); *Citizens to Preserve Overton Park v. Volpe,* 401 U.S. 402, 415, 91 S.Ct. 814, 823, 28 L.Ed.2d 136 (1971). Otherwise the courts must allow the agency to decide the issue for itself. Where an error of law has been corrected by a reviewing court, and the only issues remaining in the case are questions which have not yet been considered by the administrative agency but are nevertheless within the agency's authority, the appropriate action is a remand to the agency so that it may exercise its authority. As the Supreme Court explained in *FPC v. Idaho Power Co.,* 344 U.S. 17, 20, 73 S.Ct. 85, 86, 97 L.Ed. 15 (1952), 'the guiding principle . . . is that the function of the reviewing court ends when an error of law is laid bare. At that point the matter once more goes to the Commission for reconsideration.' *See, e.g., South Prairie Construction Co. v. Local No. 627, International Union of Operating Engineers,* 425 U.S. 800, 806, 96 S.Ct. 1842, 1845, 48 L.Ed.2d 382 (1976); *NLRB v. Food Store Employees,* 417 U.S. 1, 9, 94 S.Ct. 2074, 2079, 40 L.Ed. 2d 612

> (1974); *FCC v. Pittsville Broadcasting Co.*, 309 U.S. 134, 145, 60 S.Ct. 437, 442, 84 L.Ed. 656 (1940); *Whittaker Corp. v. United States*, 443 F.2d 1373, 1386 (Ct.Cl. 1971); *McBride v. Smith*, 405 F.2d 1057, 1059 (2d Cir. 1968); *Citizens Bank of Potawatomi Indians v. United States*, 391 F.2d 614, 624 (Ct.Cl. 1967), *cert. denied*, 389 U.S. 1046, 88 S.Ct. 771, 19 L.Ed.2d 839 (1968). Since there is no suggestion that there is any inadequacy in the Board's fact finding procedures, this case should be remanded to the Board for proceedings consistent with this opinion.

Presbyterian Hospital of Dallas v. Harris, 638 F.2d 1381, 1389 (5th Cir. 1981), *reh'g denied*, 647 F.2d 1120, *cert. denied*, 454 U.S. 940.

The erroneous standard of review employed by the court, wherein it substituted its own *de novo* findings of fact for those of the Commission below, should be reviewed and corrected by this Court on *certiorari*. The ruling deprived the Cities of any hearing or due process on an important disputed issue of fact. But even more importantly, if not corrected, the decision could open a floodgate of new unwarranted litigation in the federal appellate courts by litigants seeking *de novo* findings contrary to agency decisions based on substantial evidence of record.

CONCLUSION

For the foregoing reasons, this petition for a *writ of certiorari* should be granted and the decision below should be reviewed on its merits.

Respectfully submitted,

ILLINOIS CITIES

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July 5, 1984

ITEM A

OPINION NO. 142
OF THE FEDERAL ENERGY REGULATORY COMMISSION
JULY 12, 1982

ITEM A

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners:

C.M. Butler III, Chairman; Georgiana Sheldon,
J. David Hughes and A.G. Sousa.

Central Illinois Public Service Company Docket No. ER80-71-000

OPINION NO. 142
(Issued July 12, 1982)

This proceeding involves a wholesale rate increase application filed by Central Illinois Public Service Company (CIPSCO) in the captioned docket on November 2, 1979. The application requested an increase in wholesale revenues of $11,603,000 annually based on estimated sales and costs for the test year ending December 31, 1980. CIPSCO divided its wholesale customers into three classifications. These classifications and the increased revenues sought from each are as follows:

W-1 Cooperatives	$7,002,900
W-2 Municipals	$3,378,400
W-3 partial requirements municipals	$1,222,000

The rate proposed to be charged the W-1 cooperative customers was agreed to in advance by those customers. On February 8, 1980 [10 FERC ¶ 61,110] the Commission allowed the W-1 rates to go into effect on February 10, 1980, without suspension or further investigation and suspended the W-2 and W-3 rate until May 10, 1980, sub-

ject to refund. A hearing was ordered to determine the justness and reasonableness of the W-2 and W-3 rates, including consideration of allegations by a group of W-2 and W-3 customers of discrimination by CIPSCO against them and in favor of the W-1 customer group. The price squeeze issue was deferred to a later phase of the proceeding and intervention was granted to the Illinois Municipal Group consisting of 12 of the 14 W-2 and W-3 municipal customers. On April 9, 1980, the Commission granted rehearing of the February 8 order. Noting that the cooperative customers did not oppose the proposed W-1 rate, the Commission permitted that rate to become effective on January 1, 1980, without refund, in accordance with the parties' agreement.

On May 29, 1980, CIPSCO filed a motion to place into effect as of May 10, 1980, lower W-2 and W-3 interim rates based on the staff's "top sheets." This request was granted by the Commission on June 19, 1980 [11 FERC ¶ 61,292]. The interim rates are being collected subject to refund pending final decision.

The Initial Decision

Hearings were held on July 10, 1980, and from July 31 through August 6, 1980. Following the hearing and the submission of briefs, the presiding judge issued his initial decision on March 2, 1981. In his decision, the judge ruled on a number of issues involving the calculation of CIPSCO's cost of service and the allocation of costs to jurisdictional service. The judge determined among other things that (1) CIPSCO's demand costs should be allocated by means of the average of the company's highest hourly sales peaks for each month in the test year (12 coincident peak or 12 CP method), (2) the company's cash

working capital allowance should be zero, (3) CIPSCO's return on common equity should be 14 percent, resulting in an overall rate of return of 9.97 percent, and (4) CIPSCO's proposed W-2 and W-3 demand ratchets should be rejected. The judge further decided that the resulting W-2 and W-3 rates were discriminatory in relation to the lower W-1 settlement rates negotiated by CIPSCO and the cooperatives. To remedy this alleged discrimination for past periods, the judge ordered, for refund purposes, that the W-2 and W-3 rates be calculated using a return on equity of 13.76 percent, representing the lower end of the zone of reasonableness. To eliminate the allged discrimination prospectively, the judge ruled that CIPSCO could either (1) reduce the W-2 rate to the W-1 rate level and reduce the W-3 rate to a level comparable to the W-1 rate based on earned rate of return, or (2) file for an increase in the W-1 rate to a level equal to the W-2 rate.

Exceptions to the initial decision were filed by CIPSCO, the municipal customers, and the cooperatives.[1] Briefs opposing exceptions were filed by the CIPSCO, the cities, the cooperatives and the staff.

Upon review of the parties' briefs on exceptions, we find that with regard to the cost of service and cost allocation issues, they are without merit. The judge's decision on these issues is reasonable, supported by the evidence, and consistent with Commission precedent and proper ratemaking principles. In addition to the issues mentioned

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[1]The cooperatives did not petition to intervene in the proceeding until after the initial decision had been issued. The Commission allowed the cooperatives to submit a brief on exceptions subject to a ruling on the petition to intervene. For the reasons discussed at page 17 *infra*, the cooperatives' petition to intervene is granted.

above, we affirm the judge's decision on the following additional issues: (1) accumulated deferred investment tax credit adjustment, (2) demand and energy projections, (3) alleged company inefficiences, (4) data used for cost allocation, (5) federal wage-price guidelines, (6) normalization of taxes,[2] and (7) transmission loss factor.[3]

While the Commission is in agreement with the judge's decision on the cost-related issues, it is unable to agree with his decision on the issues involving alleged discrimination and proposed remedies therefor. The reasons for our disagreement are set forth in the following discussion.

Alleged Undue Discrimination

In accordance with its contracts with the cooperatives, CIPSCO provided the required six months' notice of its intention to seek a rate increase. Contemporaneously, it entered into settlement negotiations with the cooperatives and reached an agreement prior to its filing in this docket. The settlement rates were based, in part, on the use of a 3 CP demand allocation factor in lieu of the 12 CP factor

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[2]In accordance with order No. 144-A, issued on February 22, 1982, in Docket No. RM80-42, *et al.*, [*FERC Statutes and Regulations* ¶ 30,340], revenues associated with approved tax normalization need not be retained by CIPSCO subject to refund.

[3]In his decision, the judge determined that CIPSO had agreed in principle to the cooperatives' request for conjunctive billing for the cities of Newton, Metropolis, Greenup and Flora, Illinois. He determined that the record does not contain sufficient evidence to prescribe the details for a conjunctive billing operation and he consequently ordered the parties to exchange draft proposals and engage in good faith negotiations to implement their apparent agreement in principle. In its brief on exceptions, CIPSCO argues that until final rates are approved, the proper billing determinants for conjunctive billing will not be known. The company therefore requests that any negotiations concerning conjunctive billing be deferred until a final decision is reached by the Commission. CIPSCO's request is reasonable and is adopted.

which had been used previously by CIPSCO in calculating its wholesale rates. Similar pre-filing settlement negotiations were not held with the cities. Cities were provided with 60 days notice as required by their contracts, and subsequent to the rate filing, settlement discussions were held with the cities at which time CIPSCO offered the cities rates based on the same methods and principles as those by which the cooperative's rates were determined including, notably, use of the 3 CP demand allocator. Use of the 3 CP demand allocator resulted in W-2 and W-3 rates which, because of differences in load patterns and possibly other operating characteristics, were higher than the W-1 settlement rates. The cities refused to settle for rates resulting from the 3 CP allocator and the case proceeded to hearing. It should be noted at this point that prior to this case, CIPSCO had provided service to the cooperatives and municipalities at identical rates.

Based on this sequence of events, the cities allege that CIPSCO engaged in "secret negotiations" resulting in a "sweetheart" deal with the cooperatives to the detriment of the cities. They also allege that the cities' rates resulting from the judge's decision, since they are higher than the cooperatives' settlement rates, are discriminatory because they will adversely affect the cities' ability to compete with the cooperatives for existing and new customers.

The staff likewise argues that CIPSCO discriminated against the cities by negotiating separately with the cooperatives. It further argues that due to the similarity of service characteristics between the municipal (W-2) and cooperative customers, both classes should be served at the same rate and conversely that differences in rates as between the two classes are not cost justified. The staff recommended that the W-2 rate be reduced to the W-1 rate level, and the W-3 rate reduced to the level at which it

would earn the same rate of return to be earned from the reduced W-2 rate. This latter rate was calculated to be 8.89 percent based on the staff's cost of service.

In response to cities' and staff's arguments concerning CIPSCO's proposed customer classification, and CIPSCO's defense of the same, the presiding judge undertook a detailed analysis of various operating and cost characteristics of the two groups and concluded there were no cost or non-cost factors which would warrant any rate disparity between the W-1 and W-2 classes, but that the partial requirements municipal (W-3) customers may properly be treated as a separate class. Before proceeding to the merits of the discrimination issue it will be helpful to consider the issue of customer classification.

Most electric utilities serving numbers of wholesale customers divide their customers into convenient, logical groups for rate determining purposes. Normally these classifications are rooted in historical practice and are not controversial. Classifications may be based on voltage level, relative size of the load being served, partial versus full requirement service, or other similar criteria. One of the most widely used and accepted classifications is that between cooperative and municipal customers in the case of utilities serving both types of customers.

We agree with CIPSCO's observation that, generally speaking, a utility is entitled to classify its customers into reasonable groupings "based on differences in characteristics having cost of service implications." (CIPSCO brief on exceptions p. 40). In this case it is clear that there are significant differences between the cooperative and the cities having cost of service implications. This is evidenced by the sensitivity of resulting rates to the demand cost allocation factor used. It should also be noted, however,

that if there are in fact no service characteristics or other factors which would warrant separate rate treatment, then the rates for both classes, determined separately by uniformly applying the approved costing methods, would presumably be equal and the unnecessary classification would thus have no discriminatory effect.

Overclassification and underclassification of customers are both undesirable although the former is the lesser of evils. In order to determine precise cost responsibility, separate costs and rates can be determined for each customer using uniform cost of service and allocation methods. Differences in rates would represent differences in cost and would therefore be justified in the absence of special circumstances. In particular cases this approach may be reasonable. *See, e.g., Delmarva Power & Light Company,* 16 FERC ¶ 61,177 (1981). Underclassification is undesirable because it masks differences in costs between customers. Use of a single class insures a single, uniform rate for all customers and thus involves the risk of discriminating against lower cost customers and in favor of higher cost customers, resulting in intraclass subsidization.

In this case the presiding judge analyzed the cooperatives' and municipal's load factors based on the 12 CP demand allocation method and concluded that the differences in load factor were not sufficient to justify different demand rates. (Initial decision p. 43). He also compared the ratio of "billing demands (used for rate design) to coincident demands (used for cost allocation)." He found that using the 3 CP allocation method, a significant difference in demand rates resulted whereas under the 12 CP method only a slight difference resulted. (Ibid p. 44). The judge concluded that no justification existed for rate disparity between W-1 and W-2 classes. His decision, in

effect, treats both cooperative and W-2 municipal customers as a single class.

In our view, the question of classification is not dependent upon the results of applying a particular cost allocation method. We are generally in agreement with CIPSCO's arguments on this issue. (CIPSCO brief on exceptions, pages 33-41). It appears that customer profiles of the two groups are significantly different. The municipal systems have a concentration of general service customers with heavy air conditioning loads. The cooperatives have mostly farms and rural residential customers. Of particular significance is the fact that the W-1 customers, as a group, make their maximum demand on the company in the winter while the W-2 customers as a group make their maximum demands coincident with the company's summer peak. (Exh. 19); *See also St. Michaels Utilities Commission, et al.*, Opinion No. 490, 35 FPC 591, 597-98 (1966).

The judge notes that certain of the cooperatives exhibit summer peaking characteristics similar to the municipalities. He concludes that the company failed to adequately explain the basis for including these customers in the cooperative class. However, total uniformity within a class can hardly be expected and is not required. In *St. Michaels*, the FPC approved grouping the utility's cooperative customers in a single class notwithstanding individual variations in service characteristics (35 FPC at 596):

> "In addition, the co-operatives as a group (with some variation in the case of Accomac-Northampton) have had characteristics which differ from those of *most* of the tariff customers in that the co-operatives require less of their peak power demand coincidentally with the total system peak

than do *most* of the tariff customers. (Emphasis added.)

The matter of classification is not an exact science, and it should be considered from the standpoint not only of load factor and other cost-causing characteristics, but also from the standpoint of practicality and common sense. It is our view that a filing utility should be given a reasonable degree of latitude in classifying its customers. We alluded to the fact earlier, but it bears repeating, that the cost allocation process serves as a check on the reasonableness of a given classification system. If customers are divided into classes on the basis of a rational criterion, and if after applying the approved cost allocation methods uniformly to the classes, differing rates are produced, this is evidence that the classification was warranted due to differences in costs between the classes. If on the other hand the cost allocation process produces identical or closely comparable rates, this shows that separate classification was not necessary, *but no harm is done* because each class receives the proper (identical or comparable) cost-based rate.

In this case, the parties opposing CIPSCO's classification have analyzed various factors they consider relevant and conclude that no basis exists for rate disparity, however small, between cooperative and municipal customers. This conclusion in turn dictates their resolution of the classification issue since only by treating all wholesale customers as a single class can rate uniformity realistically be guaranteed. We believe the issue is best resolved by the process of classification and cost allocation rather than by reference to inherently subjective conclusions about alleged rate discrimination and predetermination of the need for absolute rate parity. On the record of this case, we find CIPSCO's classification system to be reasonable, supported by the evidence and consistent with concepts of

practicality and common sense. In the final analysis, the company's classification represents nothing more than a normal, standard, and accepted industry practice. It is simply not credible to argue that the classification here constitutes a form of discrimination.

It should be noted that in particular cases, the resulting rates for separate classes of customers may be so similar that it would be reasonable to establish a uniform average rate in lieu of maintaining separate, nearly equal rates. The judge so found in this case. We do not agree. While use of the 12 CP method of allocation results in a substantial reduction of the difference in unit demand costs between W-1 and W-2 customers as compared to the 3 CP method, the remaining difference is significant. Measured in terms of W-2 demand costs, the difference between an average rate and a fully allocated W-2 rate is in excess of $175,000.[4]

We now proceed with the discrimination issue. Section 205(b) of the Federal Power Act provides that no utility shall "(1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates . . . either as between localities or as between classes of service." Section 206(a) summarizes these prohibitions in the shorter phrase "unduly discriminatory or preferential."[5] These sections are modeled on provi-

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[4]$8.87 W-2 demand rate (I.D. Appendix A), less $8.61 average demand rate (Ibid) equals $.26. $.26 multiplied by W-2 billing demands of 675,670 kW (Ibid) equals $175,674.

[5]The shorthand phrase of section 206(a) has commonly been used by the Commission and the courts to describe all the elements embraced in section 205(b). While for the sake of convenience and familiarity we continue to use that shorthand, we recognize that it has sometimes masked distinctions among different fact situations: for example,

sions of the Interstate Commerce Act, whose purpose is ". . . to prevent favoritism by insuring equality of treatment on rates for substantially similar services."[6] The courts have held, however, that differences in rates may be justified where they are predicated upon differences in facts, cost of service or otherwise.[7]

The cities' witness in this case, Bruce F. Barnes, Jr., presented testimony alleging that any difference between W-1 and W-2 rates would have an anticompetitive effect. (Tr 292-295). His conclusion rested on the fact that both the cities and cooperatives are in a position to compete for existing and new loads and that any price difference in favor of the W-1 customers would give them a competitive advantage and place the W-2 customers at a competitive disadvantage. The witness also alleged that CIPSCO was "the dominant or monopoly power supplier in the area with control of all the surrounding transmission and distribution facilities" and "has almost total power over rates and conditions of service of each of the municipal or cooperative-customers." (Tr. 292). He further quoted at length and adopted certain staff testimony in prior CIPSCO wholesale rate proceedings dealing with the price

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claims of competitive injury as distinguished from claims of unfair differences in rates, or rate differences between customers with *Sierra-Mobile* contract protection and those without. This case involves a claim of injury to potential competition allegedly brought about by a settlement reached in anticipation of this rate filing.

[6]*St. Michaels Utilities Com'n, v. F.P.C.*, 377 F.2d 912, 915 (4th Cir. 1967); *United States v. Chicago Heights Trucking Co.*, 310 U.S. 344, 351 (1940).

[7]*St. Michaels, supra* at 915; *Boroughs of Chambersburg, et al. v. F.E.R.C.*, 580 F.2d 573 (D.C. 1978); *City of Frankfort, Indiana v. F.E.R.C.*, et al. No. 81-1777, 7th Circuit, Decision issued May 17, 1982.

squeeze issue. It is noteworthy that the witness also testified that actual competition is "totally irrelevant" as a test for competition or anticompetitive effects. This evidence was not rebutted by CIPSCO.

In his initial decision, the presiding judge concluded that the cities' presentation constituted a *prima facie* case comprising the dual elements of price difference and competition. In reaching this conclusion the judge applied the standards set forth by the Commissison for determining a *prima facie* case of price squeeze. *Connecticut Light and Power Company,* Docket No. ER78-517, order issued August 20, 1979, [8 FERC ¶ 61,187]. Based on cities' testimony, which he deemed to be conclusive in the absence of rebuttal, the judge found that (1) cities and cooperatives compete for the same customers, (2) CIPSCO is the "dominant" power supplier in the geographic region, and (3) CIPSCO has "almost total power over the rates and conditions of service of each of the municipal or cooperative customers." (Initial Decision, p. 49). Based on these findings, the judge concluded that any difference in municipal versus cooperative rates created an anticompetitive effect and therefore constituted undue discrimination. Upon careful review of this matter, we conclude that the judge erred in applying price squeeze standards to resolve the discrimination issue.

Price squeeze involves a special type of rate discrimination where the utility, either through its own action or as a result of state regulatory action, is able to offer a lower rate to certain of its retail customers than to comparable wholesale customers, the effect being to place the wholesale customers in a price squeeze and enable the supplier potentially to increase its monopoly position at their expense. In this type of case, the Commission has adopted special rules requiring the utility to rebut the presumption

that a price difference unfavorable to the wholesale customer will cause competitive harm and thus be deemed unduly discriminatory.[8]

The Commission has not heretofore applied the price squeeze presumptions in a non-price squeeze case and we decline to do so here. Where a temporary difference in rates as between classes of customers has a logical explanation and where that difference is not due to bad faith or improper conduct on the part of the utility then the difference should not be held unlawful in the absence of evidence, information or facts which would either demonstrate or permit the Commission to find that the disparity in rates is likely to result in actual competitive harm or would otherwise be unduly discriminatory. In this case, the cities do not allege they have lost any existing customers or failed to attract new customers as a result of the cooperatives' settlement rate nor do they allege that the cooperatives have tried to take existing or potential customers or new customers from the cities. The cities instead rely solely on the existence of two factors; (1) price difference and (2) possible competitive harm. Based on the facts of the present case, this is not enough to establish a case of undue discrimination and thereby invoke the Commission's remedial powers.

The case before us, we believe, is closely analogous to that presented in CIPSCO's last wholesale rate case in Docket No. ER78-80. There CIPSCO filed for a rate increase applicable to all of its municipal customers except Metropolis and Marshall. These latter two customers had fixed rate contracts. The cities argued that the situation thus created was discriminatory and required that

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[8]*See Connecticut Light and Power Company,* Docket No. ER78-517, order issued August 20, 1979.

CIPSCO's rate increase be rejected as to all municipal customers in order to cure the discrimination. In making these claims, cities relied on the following cases: *Town of Norwood v. F.E.R.C.*, 587 F.2d 1306 (D.C. 1978); *Public Service Company of Indiana, Inc. v. F.E.R.C.* 575 F.2d 1204 (7 Cir. 1978); *Boroughs of Chambersburg, et al. v. F.E.R.C.* 580 F.2d 573 (D.C. 1978). The presiding judge in Docket No. ER78-80 carefully analyzed these and other relevant cases and determined "that the existing rate differential between the fixed rate contracts of two customers and those customers affected by the instant rate filing does not constitute undue discrimination." (Initial decision, Docket No. ER78-80, 8 FERC ¶ 63,022, p. 59). The judge's initial decision was affirmed by the Commission in Opinion No. 75, issued on Feburary 21, 1980, 10 FERC ¶ 61,162. Opinion No. 75 was in turn affirmed on appeal by the U.S. Court of Appeals for the D.C. Circuit. *Illinois Cities of Bethany, et al. v. F.E.R.C.*, ____ F.2d ____, opinions issued August 17 and October 30, 1981. We believe the analysis of contract discrimination made by the judge in Docket No. ER78-80 is equally applicable to the discrimination dispute here. The negotiated W-1 rate settlement is analogous to a negotiated fixed-rate contract. In both cases the utility has bound itself to accept a certain rate by contract and is precluded from obtaining a higher rate during the term of the contract.

Where a rate disparity results *solely* from the fact that one customer has a fixed-rate contract and others do not, there is no undue discrimination if "nothing more" is shown. *Chambersburg,* 580 F.2d at 578. However, where there are allegations of unfairness or lack of good faith at the contract formation stage (here, the settlement negotiation stage), then the Commission must determine whether a contract (or settlement) is being used to perpetrate an

otherwise prohibited undue preference. *Norwood,* 587 F.2d at 1313.

Such a determination can be made here. In light of the allegations made by the staff and cities, the presiding judge undertook a careful review of the company's actions leading up to its filing in this docket. The judge concluded that the company's actions were not discriminatory because (1) it acted within the legal requirements of its contracts, (2) it offered the cities a settlement based on the same ratemaking principles (although not the same rates) as the cooperatives, (3) it did not advantage itself by settling with the cooperatives, and (4) its action did not cause the cities to pay in excess of the lawful rate. We agree with the judge's analysis and affirm these findings.

The cities and staff continue to argue that CIPSCO's settlement with the cooperatives was "discriminatory." We disagree. What CIPSCO did was not so much discriminatory as it was risky. CIPSCO was free to negotiate a settlement with the cooperatives, but in doing so it took the risk that separate settlement efforts with the cities would fail and that this Commission, in determining just and reasonable rates for service to the cities, would allocate costs to the cooperative service that were not reflected in the W-1 settlement rates. This in fact is what has happened.

The municipal customers argue that, because they compete with the cooperative customers, any difference in rates between the two would have an anticompetitive effect and cannot, therefore, be tolerated under Section 205(b). We disagree. Where, as here, the difference in rates is temporary and results solely from a "non-discriminatory" settlement, a stronger showing of competitive harm must be made than the general allegation of possible competitive harm that was made in this case in

order to justify disturbing the settlement or extending its benefits to non-settling parties. To hold otherwise would, in effect, eliminate partial rate settlements since the utility would run the risk of litigating a rate case with one customer and, regardless of the outcome of the litigation, being forced to offer that customer the benefits of any settlement negotiated with non-litigating customers. There is a strong public interest in the integrity and reliability of rate settlements as well as of rate contracts.[9] In the absence of partial settlements, customers groups who wished to settle could be forced to litigate whether they wished to or not. As the court stated in *Norwood, supra,* a tension arises when the policies favoring contracts (and settlements) conflict with "the concerns with fairness and avoidance of competitive advantage which underlie Section 205(b)." *Id.* at 1313. The court noted that certain forms of undue discrimination can be grounds for disturbing a contract under the *Sierra* test.[10] However, it stated that the simple fact that parties protected by a contract pay less than those not so protected is insufficient grounds for such a remedy and that otherwise, *Sierra* would provide scant protection to the contracting process. 587 F.2d at 1313. Likewise, we

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[9]The importance of settlement as a fundamental tool of the administrative process is reflected in the basic requirement of the Administrative Procedure Act, 5 U.S.C. 554(c), that agencies provide an opportunity for "the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment ***." *The Attorney General's Manual on the Administrative Procedure Act* (1947) explains that this requirement stemmed from the Attorney General's Committee Report, which viewed "informal procedures" as constituting "the vast bulk of administrative adjudication" and as "truly the lifeblood of the administrative process." *Id.* at 48. The purpose of the requirement is to provide "so far as practicable, for the informal settlement or adjustment of controversies in lieu of formal adjudicatory proceedings."

[10]*F.P.C. v. Sierra Pacific Power Co.,* 350 U.S. 348 (1956).

find that a difference in rates resulting from a settlement with some customers, coupled with generalized allegations of possible anti-competitive effect, are insufficient grounds for disturbing the settlement or automatically extending its benefits to nonsettling parties where, as here, there is no reason to question what happened at the settlement negotiation stage.

We believe the end result of our decision is reasonable. CIPSCO negotiated a settlement with the W-1 customers and must live by that agreement despite the fact that the settlement rate has been rendered inadequate by our present decision. This is a logical consequence of CIPSCO's decision to settle with the W-1 customers on the basis of cost principles not in conformity with then-existing or historical practice, notwithstanding CIPSCO's undoubted faith in the cost methods used to derive the settlement rates. At the same time, we believe it is unnecessary, in the absence of any evidence of competitive harm, to compound CIPSCO's problem by reducing the W-2 and W-3 rates below the level found to be just and reasonable based on fully allocated costs. It should be noted that in this case the W-1 rate is being increased, albeit to a lesser extent than the W-2 and W-3 rates, while in Docket No. ER78-80, the two fixed rate municipalities were exempt from any increase in rate. Also significant is the fact that the present rate differential is likely to be temporary, lasting only until CIPSCO's next wholesale rate filing at which time CIPSO can be expected to attempt to cure the revenue deficiency attributable to its W-1 rates. In light of our decision, we find it is unnecessary to rule on the judge's proposed remedies.

In addition to economic remedies, the judge ordered CIPSCO to make a formal offer in writing to its W-2 and W-3 customers to amend their contracts to provide six

months advance notice of rate increase filings, thus conforming the notice provisions of the contracts to the terms of the W-1 contracts. The judge required CIPSCO to file its offer with the Commission. In its brief on exceptions, CIPSCO argues that the judge's order is erroneous in the absence of any finding that the existing W-2 and W-3 contracts are unjust or unreasonable. However, CIPSCO states it is willing on a voluntary basis to provide the municipal customers with six months notice of future rate filings. In our judgement, this matter should be left for resolution by the parties on a mutually agreeable basis. The record does not support mandatory rewriting of the contracts at this time.

MOTION TO REJECT

On January 22, 1982, the cities of Flora and Greenup, Illinois filed a motion requesting the Commission to reject CIPSCO's rate increase as to them and to require CIPSCO to refund all increased revenues collected from them in this docket. The cities' claim is based on the terms of their contracts with CIPSCO which provide in pertinent part as follows:

> The term of this agreement shall be for a period of 20 years from and after the effective date hereunder; provided, however, that the rates and charges for service hereinbefore set forth shall apply only during the first ten years of the period, and the rates and charges for the second ten years of the period shall be mutually agreed to by both parties subject to the approval of the regulatory body or bodies as may have jurisdiction thereof.

The contracts were executed in June 1965, became effective on September 1, 1965, and were filed with and ac-

cepted by the FPC. Flora and Greenup argue that under the terms of the contracts, CIPSCO may charge them higher rates only if the new rate is mutually agreed to by the parties and approved by the Commission. The cities state they do not agree to any increase in their rates.

On April 27, 1982, the cities of Casey and Newton, Illinois filed a complaint against CIPSCO in Docket No. EL82-15-000 seeking the same relief as Flora and Greenup, and requesting consolidation of the complaint with Docket No. ER80-71, CIPSCO's contracts with Casey and Newton are in all material respects identical to its contracts with Flora and Greenup. We shall treat the April 27 complaint as a motion. The complaint Docket No. EL82-15-000 is unnecessary and is terminated and the request for consolidation is deemed moot.

In its response to the motion of Flora and Greenup, CIPSCO does not dispute the fact that the terms of the contracts have not been complied with. Instead, it relies on the fact that subsequent to the expiration of the first 10 year term in 1975, the cities have acquiesced in CIPSCO's successive rate filings with this Commission. CIPSCO argues that this acquiescence amounts to subsequent conduct having the effect of modifying the contract and that "it is simply too late for Cities to now protest that they are secure in their contracts and cannot be held to the terms of their tacit agreement to substitute Commission rate making for the unworkable and outdated provision in their 1965 contracts." (CIPSCO answer, p.8).

CIPSCO's argument is not persuasive. Similar arguments were considered and rejected in a recent case involving *Utah Power and Light Company,* Opinion No. 113, issued on February 23, 1981 [14 FERC ¶ 61,162]. *See also Louisiana Power & Light Company v. F.E.R.C.,* 587

F.2d 671 (5th Cir. 1979). it is more reasonable to conclude that the cities by their actions have previously waived their right to assert the contract defense but that they have not modified the contracts and remain free to assert their previously waived rights if they so choose.

Nor have the cities waived their right to assert a contract defense in this case. The cities offer no explanation why their motions were not properly filed at an early stage of the proceeding. Nevertheless, as we pointed out in *Utah,* waiver is an equitable principle which serves to avoid harsh results when the conduct of a party makes those results unfair. Here, we can perceive no unfair disadvantage or injury to CIPSCO in the event Cities' motion is granted. CIPSCO is harmed no more by granting the motion now than it would have been had a similar motion been granted at the time of suspension. It appears that a hearing would have been required in any event to resolve the issues contested by other cities. Consequently CIPSCO's waiver argument is rejected.

On May 21, 1982, CIPSCO filed its answer to the Casey-Newton complaint. In addition to the arguments previously raised and discussed alone CIPSCO raises a new defense. It argues that these contracts are either unenforceable as a result of being too indefinite or, alternatively, constitute "open price term" contracts requiring only that a reasonable price be set. We do not accept CIPSCO's argument concerning the possible unenforceability of the rate change provisions of the contracts or the potential consequences thereof. It is not clear to us what the effect would be, in the present regulatory context, if these provisions were held to be unenforceable. We find it unnecessary to pursue this issue, however, since we conclude that the contracts constitute open price term contracts within the meaning of the Uniform Commercial Code (U.C.C.) and as such are valid and enforceable.

It appears that the contracts in question represent "agreements to agree" and would be unenforceable under the traditional law of contracts as too indefinite 17 Am.Jr.2d, Contracts, § 26. However, as it applied to this category of contracts, the traditional law was modified by the U.C.C., which has been adopted by every state except Louisiana. The U.C.C. provides in pertinent part as follows, § 2-305:

> (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time of delivery if
>
> * * *
>
> (b) the price is left to be agreed by the parties and they fail to agree; . . .

Several questions are presented in this case involving selection of the applicale law and the application of the law to the contracts in question. In resolving these questions, the Commission will apply the principles set forth in the recent judicial decision *Pennzoil Co.* v. *F.E.R.C.*, 645 F.2d 360 (5thCir. 1981). In that case, the court affirmed the Commission's application of "general principles of contract law" in resolving controversies arising before the Commission under contracts of jurisdictional utilities. The court held that in the absence of significant conflict between federal interests and the use of state law in the interpretation of contracts, "the appropriate contract law to apply is the law that would govern the parties dealings were there no regulation at all of the contract's subject matter." 645 F.2d at 387 (footnote omitted). The court place the burden on the parties to inform the Commission if state law is different from general principles and further stated as follows, *Ibid.*

Since the Uniform Commercial Code applies to natural gas sales as the sale of goods, U.C.C. §2-107(1), and all states except Lousiana have adopted the UCC, variations between state law and general principles are likely to be few. When such differences appear, however, FERC must follow state law.

Consistent with *Pennzoil*, we believe the U.C.C. represents the prevailing "general principles of contract law," and that it is proper to apply the principles set forth in the U.C.C. in ruling on the contracts here in dispute. Since Illinois has adopted the U.C.C., including section 2-305 in unmodified form, there is no divergence between state law and general principles.

Applying section 2-305 to these contracts, we reach the following conclusions: (1) the sale of electrical energy is directly analogous to the sale of natural gas and is therefore within the purview of 2-105 of the U.C.C., (See §2-105:5), (2) the parties intended to conclude contracts for the sale of electrical energy even though the prices for the second 10 year period of the contracts were not settled, (3) the prices were left to be agreed by the parties subject to Commission approval and they have failed to agree, (4) in such circumstances the price is a reasonable price at the time for delivery, (5) the reasonable price is represented by the just and reasonable W-2 rate established by this order based on CIPSCO's fully allocated costs, (6) in light of the lack of any provision in the contracts authorizing a unilateral rate filing by CIPSCO under section 205 of the Federal Power Act, the approved rate shall be effective only prospectively from the date of this order pursuant to section 206 of the Act. *Papago Tribal Utility Authority* v. *F.E.R.C.*, 610 F.2d 914 (D.C. Cir. 1980).

In reaching these conclusions we take particular note of the fact that the contracts state that "rates and charges" for the second 10 year period are to be mutually agreed upon. This is quite different than if the contracts had specified mutual agreement as to "changes" in the initial rates and charges. In the latter case it would be reasonable to conclude that in the absence of agreement the parties intended the pre-existing rates to continue in effect. In this case, however, that finding cannot fairly be made. Just as the customers do not agree to any rate increase, so CIPSCO does not agree to the continuation of the old rate. The contract states that the initial contract rates shall apply *only* during the first 10 year term. The converse of this statement is that the initial rates are *not* to apply during the second 10 year term. It therefore seems reasonable and logical as well as consistent with sound legal principles for the Commission to establish the rates during the second 10 year term where the parties are unable to do so by mutual agreement.

The Commission recognizes that its decision here is in conflict with the order issued in *Middle South Services, Inc.*, Docket No. ER80-752, on February 6, 1981, 14 FERC ¶ 61,105. In that case the Commission, in reviewing a similar contract between Gulf States Utilities Company and Louisiana Power and Light Company, Inc., held that the contract was a fixed rate contract which could be changed only by the mutual consent of the parties, and that in the absence of mutual agreement, no changes in the contract rate could be made under either section 205 or 206 of the Act. Upon careful review of this matter, we conclude that the prior holding in *Middle South* should be overruled as inconsistent with proper legal standards. Therefore, to the extent inconsistent with this order *Middle South* is overruled and the decision set forth in this order is adopted.

On June 21, 1982, the cities of Casey and Newton filed a reply in opposition to CIPSCO's May 21 answer to their complaint. On June 28, 1982, CIPSCO filed a motion to strike to cities' reply. In ruling on this issue, the Commission has considered both the cities' reply and CIPSCO's motion to strike. The motion to strike is denied.

Petition to Intervene

The cooperatives petitioned to intervene following issuance of the initial decision. The Commission deferred action on the petition but permitted the cooperatives to submit briefs in the interim. In their petition, the cooperatives argue that they had no reason to intervene in the proceeding since they had reached a settlement with CIPSCO and the settlement rates were accepted by the Commission. They claim that the settlement rates were placed in jeopardy by the initial decision in which the judge ordered CIPSCO to either reduce its W-2 and W-3 rates or, alternatively, increase its W-1 rate.

The cooperatives contend that the judges' proposed remedy was based on the absence of evidence to rebut the cities' allegations concerning the competitive relationship between the cooperatives and cities. They argue that they had never been put on notice that their competitive relationship with the cities was an issue, and that had they been aware of this issue, they could have and would have rebutted the cities' allegations. The cooperatives state their willingness to accept the record as they find it, but request intervention in order to protect their vital interests.

The petition to intervene is opposed by the cities. Cities argue that the cooperatives have not demonstrated good cause for their delay in seeking intervention, pointing out that the Commission's suspension order noted cities' alle-

gations of discrimination resulting from the CIPSCO-cooperative settlement and set the discrimination issue for hearing. They further point out that Carl Dufner, Director of the Energy, Environment and Engineering Department of the Association of Illinois Electric Cooperatives, presented testimony in the proceeding in support of the 3 CP demand allocation method. Finally, the cities argue that the cooperatives do not have a valid interest in this proceeding which would justify their intervention. Cities argue that the Commission is without power retroactively to modify the W-1 settlement rate, and that if CIPSCO does file to increase the W-1 rate prospectively, the cooperatives would have every right to protect their interests in that proceeding. Cities further point out that the cooperatives were not aggrieved by the judge's decision since CIPSCO has the right at all times to seek an increase in its W-1 rate and does not require the permission or order of the presiding judge or the Commission.

Upon review of this matter we conclude that the cooperatives should be allowed to intervene in the proceeding to the limited extent of permitting the filing of the previously authorized posthearing briefs. While the cooperatives' arguments in support of intervention are less than compelling, there can be no doubt they have a valid interest in this case not adequately represented by other parties. We also believe there is some merit to the explanation provided for their failure to intervene prior to issuance of the initial decision. Finally, granting of the petition to intervene will not result in any delay in resolving this proceeding nor does granting the petition prejudice the rights of other parties.

On March 12, 1982, the Cooperatives filed a motion for leave to file a supplemental brief on exceptions. The sup-

plement addresses an alleged conflict between the initial decision in this case and an initial decision issued subsequently in another proceeding. The motion is without merit and is denied.

Both CIPSCO and the cooperatives filed motions requesting the Commission to hold an oral argument in this cause. Cities oppose the motions. Upon consideration of the motions we find that oral argument is unnecessary. The issues have been extensively and ably argued in the parties' briefs and we are not persuaded that further argument is required.

The Commission orders:

(A) The initial decision issued herein on March 2, 1981, is affirmed in part and modified in part in accordance with the terms of this order.

(B) Within 75 days from the date of this order, CIPSCO shall file revised rates and supporting cost of service data in accordance with the terms of this order.

(C) Within 30 days following approval of the rates submitted pursuant to paragraph (B) above, CIPSCO shall refund all amounts collected in excess of the approved rates together with interest calculated in accordance with section 35.19(a) of the Commission's regulations. Within 10 days therafter, CIPSO shall file a statement showing the amount of refunds and interest paid.

(D) Within 75 days from the date of this order, CIPSCO shall refund to the cities of Greenup, Flora, Casey and Newton, Illinois, all increased revenues collected in this docket prior to the date of this order, together with interest thereon. Within 10 days thereafter CIPSCO shall file a statement showing the refunds and

interest paid. Commencing on the date of this order, CIPSCO may charge the cities the approved W-2 rate.

(E) The cooperative customers are permitted to intervene in this proceeding. The cooperatives' briefs on and opposing exceptions to the initial decision are accepted for filing.

(F) The Cooperatives' motion of March 12, 1982, is denied.

(G) The motions requesting oral argument are denied.

(H) Docket No. EL82-15-000 is terminated.

(I) CIPSCO's motion to strike filed on June 28, 1982, is denied.

Commissioner Sheldon voted present.

ITEM B

OPINION NO. 142-A DENYING APPLICATIONS FOR REHEARING AND MOTIONS FOR STAY ISSUED BY THE FEDERAL ENERGY REGULATORY COMMISSION SEPTEMBER 30, 1982

ITEM B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Opinion 142-A

Central Illinois Public Service Company,
Docket Nos. ER80-71-001, -002, -003

OPINION OR ORDER DENYING
APPLICATIONS FOR REHEARING
AND MOTIONS FOR STAY
(Issued September 30, 1982)

Timely applications for rehearing of Opinion No. 142, issued herein on July 12, 1982, have been filed by Central Illinois Public Service Company (CIPSCO), the municipal intervenors, and the cooperative intervenors. In Opinion No. 142, the Commission affirmed in part and modified in part the presiding judge's initial decision and established CIPSCO's just and reasonable rates in this docket, rejected allegations that the approved W-2 municipal rates are discriminatory in relation to lower W-1 cooperative settlement rates, and decided a contract interpretation issue by holding that under contracts with four municipal customers, the approved W-2 rates could be made effective by CIPSCO only prospectively.

In their applications for rehearing, the parties continue to present arguments in support of their positions on the basic cost of service, discrimination and contract issues involved in this proceeding. Upon review of the applications, the Commission finds that no new facts or principles of law have been presented which would warrant modifying Opinion No. 142. Several of the arguments presented, however, warrant further consideration and comment.

The municipalities allege the Commission has adopted a new legal standard in deciding the discrimination issue by requiring some showing of actual competitive harm or some facts or information which would permit the Commission to conclude that competitive harm was a reasonable likelihood as a result of the disputed rate differential. The municipalities are in error. It is the price squeeze cases, upon which they rely, which are the exceptions to the general rule. As noted in Opinion No. 142, the Commission had adopted a special rule in price squeeze cases under which a difference in a utility's retail and wholesale rates for comparable services, in favor of the retail service, is presumed to have an anti-competitive effect on the wholesale customer. It is up to the utility to rebut the presumption. *Connecticut Light and Power Company,* Docket No. ER78-517, order issued August 20, 1979 [8 FERC ¶ 61,187]. In non price squeeze, customer versus customer discrimination cases such as this, where a showing of actual or reasonably foreseeable competitive harm is required before modifying otherwise just and reasonable cost-based rates to conform to contract or settlement rates of other customers, the test has been and continues to be that stated in Opinion No. 142. *See e.g. Southwestern Public Service Company,* Opinion No. 451, 33 FPC 343, 350-351 (1965); *St. Michaels Utilities Commission, et al.,* Opinion No. 490, 35 FPC 591, 599-600 (1966); *aff'd* 377 F.2d 912 (4th Cir. 19767), *Southern California Edison Company,* Opinion No. 821, 59 FPC 2167, 2186 (1977).

In the absence of any substantial evidence on the issue of actual or likely competitive harm, it is simply not reasonable to assume that the temporary difference between the cooperative and municipal rates is unduly discriminatory. Based on staff data referred to by the presiding judge, CIPSCO's overall rate of return on W-1

cooperative service is 8.89 percent (Initial decision [14 FERC ¶ 63,047], mimeo. p.46), while the rate of return for W-2 and W-3 service approved in Opinion No. 142 is 9.97 percent. It is not reasonable to base the ultimate decision on just and reasonable rates in this case on the assumption that a temporary difference in rates represented by 1.08 percent of return would cause a shift of existing customers or determine the geographical location of potential new customers, or otherwise cause any change in the competitive business relationship between the cooperatives and municipalities. *See City of Frankfort, Indiana v. F.E.R.C.,* F.2d decided May 17, 1982 (7th Cir.)

The cities seek rehearing of the Commission's decision to allow CIPSCO to begin collecting the just and reasonable W-2 rate from the Cities of Flora, Greenup, Casey and Newton, Illinois as of July 12, the issue date of Opinion No. 142. The cities argue that the Commission has not complied with the requirements of section 206(a) of the Federal Power Act, which requires a finding that a utility's prior rate is unjust, unreasonable, unduly discriminatory or preferential before a new rate can be prescribed. The issue of the applicability of section 206 to the facts of this and other similar cases involves several questions which we will take this opportunity to consider.

There are essentially two categories of cases. First is the type of case represented by *F.P.C. v. Sierra Pacific Power Co.,* 350 U.S. 348 (1956). In this case the Supreme Court held that where a utility's contract with its customer is a fixed rate contract, the Commission may prescribe a higher rate under section 206 only upon a finding that the contract rate is "so low as to adversely affect the public interest — as where it might impair the financial ability of the public utility to continue its service, cast upon other customers an excessive burden, or be unduly discrimi-

natory." (350 U.S. 355). The burden in this type of case is difficult if not impossible to meet. We are not aware of any case arising under the Federal Power Act in which rate relief has been granted under the *Sierra* standard. *See e.g.* Opinion No. 764, *Metropolitan Edison Company,* 55 FPC 2583 (1976).

The second category of cases, of which this one is an example, arises because the language of the contract is held to permit a rate change, but not a "unilateral" rate change under section 205, under which a proposed rate is permitted to become effective immediately following a suspension period which by statute may not exceed five months. Instead, the new rate can become effective only prospectively from the date of final Commission approval. Apparently because of the prospective nature of the final rates, these cases are generally referred to as being within the scope of section 206. *Papago Tribal Utility Authority v. F.E.R.C.,* 610 F.2d 914 (D.C. Cir. 1979).

In our view it would be more logical to say that these cases arise under section 205 but that under the terms of the contract the utility has surrendered its right to the protection of the suspension provisions of section 205. However, whether viewed as section 205 or 206 cases, the ultimate rates should in both cases be the same in our judgment. The contract issue involves the question of *when* Commission-approved rates are permitted to become effective. It should not be held as involving the *level* of rates. The rate CIPSCO is permitted to collect from the four cities should not be different than the W-2 rate approved for all of the other W-2 cities.

Based on the above considerations, the Commission believes that in the context of this case, it is unnecessary to make specific findings that CIPSCO's prior rates were un-

just and unreasonable as a predicate to authorizing the just and reasonable W-2 rate to be made effective prospectivley to the four cities. *P.S.C. of New Mexico v. F.E.R.C.*, 628 F.2d 1267, 1270 (10th Cir. 1981). This is not to say that the requirements of 206 are not met even if it is assumed these are section 206 cases. The W-2 rates approved as just and reasonable in Opinion No. 142 are substantially higher than those previously in force. The approved rates are based on CIPSCO's fully allocated costs including a fair and reasonable return. To the extent of difference between the old and new rates, the old rates are less than compensatory based on fully allocated costs and yield a rate of return below that found by the Commission in this proceeding to be just and reasonable. Based on these facts, we conclude that to the extent of difference between the old and new rates, the old rates are unjust and unreasonable.

The pre-filing W-2 rates when measured in relation to the approved cost of service under Opinion No. 142 result in a return on common equity of approximately 1.7 percent.[1] If it is ultimately determined by a reviewing court that a section 206 finding relative to the prior rates is required, and if it is further held that such finding cannot be made on the basis of fully compensatory rates, then based on the 1.7 percent equity return under the pre-filing W-2 rates, we find that those rates are unjust and unreasonable.

CIPSCO seeks rehearing of the Commission's rejection of demand ratchets for W-2 and W-3 service. It points to

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[1]The 1.7 percent estimate was developed by the Commission's staff using cost of service data in the record adjusted to conform to the requirements of Opinion No. 142. Revenues are based on the pre-filing W-2 rate.

several cases in which the Commission has permitted demand ratchets for partial requirements service. It further quotes the presiding judge's statement that the self-generating ability of the W-3 customers "calls for a different billing rate design approach" than that used for the full requirement W-2 customers. CIPSCO says it does not understand what that different approach should be. CIPSCO's basic argument is that without a ratchet, the W-3 customers, with their generating capability, "can avoid paying the average annual cost of the kilowatts they demand at peak by taking those kilowatts only when they need them, at the time of CIPSCO summer peaks." CIPSCO's arguments are without merit and are rejected.

CIPSCO is entitled to recover from its W-2 and W-3 wholesale customers the costs allocated to serving them. Demand rates are computed by dividing allocated demand costs by projected (test period) billing demands. The resulting demand rates are applied to the services provided, and the allocated demand costs are thereby recovered.

CIPSCO has failed to demonstrate that a ratchet is necessary to insure recovery of its demand costs either as to W-2 or W-3 service. As to W-3 customers, while it is true they have their own generating capacity, that fact is well known and is reflected in the test year W-3 billing demands. Only if the W-3 customers deviated significantly from the test year projections would the recovery of demand costs be affected. CIPSCO has provided absolutely no basis to conclude that the test period W-3 billing demand data is unrepresentative for ratemaking purposes. The same principles apply to the W-2 customers. In short, CIPSCO has not demonstrated and the Commission will not accept the proposition that CIPSCO is unable to derive compensatory W-2 and W-3 rates without using demand ratchets.

On September 13, 1982, CIPSCO filed a motion requesting a partial stay of Opinion No. 142 pending action on the applications for rehearing and until any judicial review of the opinion has been completed. CIPSCO seeks a stay of that portion of Opinion No. 142 which requires it to refund to the cities of Flora, Greenup, Casey and Newton, Illinois, all increased revenues collected in this docket prior to the July 12 issue date of Opinion No. 142. On Septemer 15, 1982, CIPSCO filed a motion requesting a complete stay of its refund and filing obligations under Opinion No. 142 pending action on the applications for rehearing, and renews its request for a partial stay pending judicial review in the event the Commission rejects its arguments for rehearing of the four cities' contract issue.

Upon review of the motions, the Commission finds that CIPSCO has not demonstrated good cause to stay the refund or filing requirements of Opinion No. 142. CIPSCO has not demonstrated that in the absence of a stay it will suffer irreparable harm and has not presented other grounds which would justify its request. The motions will therefore be denied.

The Commission orders:

(A) The applications for rehearing of Opinion No. 142 are denied.

(B) CIPSCO's motions of September 13 and 15, 1982, are denied.

ITEM C

CITIES OF BETHANY, BUSHNELL, ILLINOIS, ET AL. V. FEDERAL ENERGY REGULATORY COMMISSION, 727 F.2d 1131 (D.C. Cir. 1984)

ITEM C

CITIES OF BETHANY, BUSHNELL, ILLINOIS *ET AL.*,

Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent,

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,

Intervenor.

Nos. 82-2168, 82-2189, 82-2301

UNITED STATES COURT OF APPEALS, DISTRICT OF COLUMBIA CIRCUIT.

Argued September 22, 1983

Decided February 7, 1984

Before WILKEY and WALD, Circuit Judges, and MacKINNON, Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge WILKEY.

WILKEY, Circuit Judge:

Petitioners seek review of two orders of the Federal Energy Regulatory Commission ("FERC" or "the Commission") pertaining to a wholesale rate filing made by Central Illinois Public Service Company ("CIPS") in 1979[1]. The three sets of petitioners are: CIPS, which is a

[1] *Central Illinois Public Service Co.*, Opinion No. 142, 20 FERC (CCH) ¶ 61,043 (1982); *Central Illinois Public Service Co.*, Opinion No. 142-A, 20 FERC (CCH) ¶ 61, 435 (1982).

utility that sells electrical power at wholesale; a group of twelve Illinois cities ("the Cities"), all of which are wholesale customers of CIPS;[2] and the Illinois Cooperative Group ("the Coops"), which is comprised of rural cooperatives that also purchase electricity at wholesale from CIPS. Each of the three sets of petitioners challenges different aspects of FERC's orders.

We affirm FERC in all respects except for its interpretation of the contracts between CIPS and four of its municipal customers. We reverse FERC's determination that the rates under the contracts must be applied prospectively only, from the date of FERC's order in this case.

I. Background

On 2 November 1979 CIPS made a wholesale rate filing with FERC. The rate filing sought rate increases for CIPS's three classifications of wholesale customers: the Coops in group W-1; the full requirements city customers in W-2; and the partial requirements city customers in W-3. Prior to this contested rate filing, CIPS historically had charged the same rate to its W-1 customers (Coops) as it did to its W-2 customers (full requirements cities), despite their separate customer classifications. CIPS's 1979 wholesale rate filing, however, sought a greater increase in the rates to be charged to the W-2 city customers than it did for the rates to be charged to the W-1 cooperative customers.[3]

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[2]The twelve cities are Bethany, Bushnell, Cairo, Carmi, Casey, Flora, Greenup, Marshall, Metropolis, Newton, Rantoul, and Roodhouse, Illinois.

[3]*See* Joint Appendix (J.A.) at 698, 808-09.

In accordance with contracts between CIPS and the Coops, CIPS had given the Coops six months' advance notice of its proposed wholesale rate filing. Pursuant to this advance notice, CIPS and the Coops entered into settlement negotiations which resulted in the Coops' agreeing not to challenge the proposed rate filing at FERC. Contracts between CIPS and the Cities did not contain a similar notice provision and CIPS merely gave the Cities the more limited, 60 days' notice required by the Federal Power Act.[4]

Because the Coops had agreed to the proposed rate increase in advance, the Commission permitted the W-1 rate to take effect without suspension. FERC, however, imposed a suspension on the effective date of the W-2 and W-3 rate increases, and then proceeded to investigate the propriety of those proposed rates under the Federal Power Act. A hearing on CIPS's proposed increases in rates charged to the Cities was held before an Administrative Law Judge, at which hearing CIPS, the Cities, and FERC's staff all participated.

In the proceedings the Cities challenged the justness and reasonableness of the W-2 and W-3 rates, and also charged that CIPS's proposed rates were unlawfully discriminatory because of the disparity between the rates to be charged to the Coops and the Cities. The Cities further claimed that CIPS's proposed change to a new method of allocating fixed costs among customers was not reasonable. In addition, the Cities raised several miscellaneous cost-of-service issues. The ALJ's Initial Decision of 2 March 1981 concluded that the differential between rates for the Coops and the Cities was unduly discriminatory, and that the CIPS's proposed use of a "3-CP" method of

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[4]*See* 16 U.S.C. § 824d(d) (1982).

allocating costs was not reasonable.[5] The ALJ ruled against the Cities on several miscellaneous cost-of-service issues.

Exceptions to the Initial Decision were filed with the Commission by CIPS and the Cities. In addition, the Coops were permitted to intervene in the proceedings before FERC in support of CIPS's position, which urged the Commission to reverse the ALJ's rejection of CIPS's proposed method of allocating costs. In addition, four of the Cities made the argument, not previously made to the ALJ, that the proposed rate increase could not be applied to them, because their private contracts with CIPS prohibit unilateral rate filings.

On 12 July 1982 the Commission affirmed in part and reversed in part the ALJ's Initial Decision, and FERC's order established the just and reasonable rates that CIPS was permitted to charge.[6] FERC affirmed the ALJ's decision with respect to the demand cost allocation method and several miscellaneous cost-of-service issues. While adopting the ALJ's findings of fact on the discrimination claim, however, FERC determined that the rate differential between the Cities and the Coops was not unduly discriminatory, overruling the ALJ on that point. Finally, FERC interpreted the contracts between four municipal customers and CIPS as prohibiting unilateral rate filings by CIPS. It construed those contracts to provide that FERC itself would establish rates under the contract when the parties failed to agree on specific rates, and that those established rates could only be applied prospectively. Accordingly, it ordered CIPS to refund to the four cities the

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[5]*Central Illinois Public Service Co.*, Initial Decision, Docket No. ER80-71 (2 March 1981), J.A. at 696.

[6]Opinion No. 142, 20 FERC (CCH) ¶ 61,043 (1982).

increases in rates collected from the four Cities from the time of the effective date of CIPS's unilateral filing to the date of the Commission's order setting the reasonable rates in this case.

On 30 September 1982 FERC issued a subsequent order, in which it denied applications for rehearing and it further explained its determinations on the discrimination and contract issues.[7] Petitioners petitioned this court for review of those two orders of the Commission.

II. Analysis

A. *The Cost Allocation Method*

A principal element in CIPS's rate schedule is the demand charge, which allocates fixed costs among customers. CIPS's 1979 rate filing proposed to allocate fixed costs among customers based on each customer's demand for electricity during CIPS's peak sales months of June, July and August. This method of cost allocation is known as a 3-CP method, because of its use of a coincident peak of three months. Prior to its 1979 filing, CIPS had used a 12-CP method, which apportioned fixed costs among customers based on each customer's demand for electricity in each of twelve months. Because the Cities' purchases of electricity are the greatest during the summer months and the Coops' demand peaks in the winter, CIPS's proposed use of the 3-CP method would have resulted in a higher proportion of fixed costs being allocated to the Cities than was allocated to them under the previously employed 12-CP method.

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[7]Opinion No. 142-A, 20 FERC (CCH) ¶ 61,435 (1982).

The Commission affirmed the ALJ's conclusion that CIPS's proposed use of a 3-CP method of allocating costs among classes of customers was not reasonable. On review, the Coops argue that FERC and the ALJ used an incorrect legal standard to assess the propriety of CIPS's proposed use of a 3-CP cost allocation method.[8] CIPS contends that FERC's decision on the demand cost allocation method is not supported by substantial evidence on the record considered as a whole. Both ERC and the Cities take the position that FERC made a reasonable policy determination on the proper cost allocation method and that FERC's decision is supported by substantial evidence on the record considered as a whole.

The Coops' contention that the ALJ erred by requiring CIPS to prove that the proposed 3-CP method was *more* reasonable than the 12-CP method is not correct; neither the ALJ nor FERC employed that standard. The Federal Power Act requires that all rates charged by public utilities

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[8]FERC contends that the Coops lack standing to petition for review of FERC's decision on the reasonableness of CIPS's cost allocation method. Brief for Respondent at 38-39. We find that the Coops are sufficiently aggrieved by the Commission's orders to be proper petitioners before this court. Section 313(b) of the Federal Power Act, 16 U.S.C. § 8251(b) (1982) grants standing to "[a]ny party to a proceeding under this chapter aggrieved by any order issued by the Commission in such proceeding." The Commission permitted the Coops to intervene in this case when the cost allocation issue was before the Commission. The Coops' settlement agreement with CIPS does not deprive them of standing to seek review of FERC's order rejecting CIPS's proposed use of a 3-CP method of allocating costs. Although the rate design settled upon by CIPS and the Coops in 1979 utilized a 3-CP cost allocation method, FERC's requirement that CIPS use a 12-CP cost allocation method is likely to affect rates charged to the Coops. Costs allocated to the Coops by the Commission mandated 12-CP method are not reflected in the Coops' settlement rates. Indeed, in November of 1982, immediately after FERC issued its final order in this case, CIPS filed to increase its rates to the Coops. *See Central Illinois Public Service Co.,* Docket No. ER83-78-000.

be "just and reasonable."[9] In the past FERC has interpreted its authority to review rates under this provision of the Act as limited to an inquiry into whether the rates proposed by a utility are reasonable — and not to extend to determining whether a proposed rate schedule is more or less reasonable than alternative rate designs.[10] Adopting the usual standard, the ALJ determined, and the Commission agreed, that CIPS only bore a burden to demonstrate that its proposed 3-CP method of allocating costs was reasonable; CIPS was not required to prove that its proposed 3-CP method was *more* reasonable than the 12-CP method which it had previously employed. The ALJ stated:

> [T]he standard for the decision is . . . not whether a 12 CP method is more appropriate than a 3 CP method, but rather whether the 3 CP method is reasonable and adequate.[11]

The ALJ did not put a burden on CIPS to prove that its proposed cost allocation method was superior to alternative allocation methods.[12] FERC's decision did not adopt an incorrect legal standard for assessing the propriety of CIPS's proposed use of a 3-CP method of allocating costs under the Federal Power Act.

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[9]16 U.S.C. § 824d(a) (1982) ("rates or charges shall be just and reasonable").

[10]*See Public Service Co. of Indiana,* 56 FPC 3003 (1976).

[11]Initial Decision at 5; J.A. at 701.

[12]Furthermore, even if the ALJ had used a relative reasonableness approach in evaluating the proposed cost allocation method, such a standard may be proper. *See, e.g., Idaho Power Co.,* 3 FERC (CCH) ¶ 61,108 at 61,301-03 (1978) (Holden, Commissioner, concurring) (inquiries into the "relative reasonableness" of other proposed methods are not contrary to the Federal Power Act).

Furthermore, the application of the proper legal standard to a proposed cost allocation method involves important policy choices about how costs of services should be allocated among customers.[13] Under the 3-CP method, fixed costs are allocated on the basis of a customer's contribution to the system's peak demand; the premise of his method is that fixed costs such as plant size are determined by the demand on the system during the three peak months. The 12-CP method, by contrast, assumes that a utility's fixed costs principally relate to the demand on the utility throughout the year, and not to the maximum load on the system during its months of peak demand.[14] Because each utility is unique, FERC has eschewed a rigid approach in assessing whether a proposed method of allocating fixed costs among customers is reasonable. In this case the Commission found that a method of allocating costs based on CIPS's three peak summer months was not reasonable, because there was a high demand on CIPS's system throughout the year.[15] The Commission's policy determination that the 3-CP method is not reasonable under the facts of this case warrants substantial deference from this court.[16] We find that the standard used by the ALJ and FERC in this case was proper.

The Coops further allege that the ALJ made an error of law by failing to heed the views of the Illinois Commerce Commission when the evaluated the reasonableness of CIPS's proposed cost allocation method. Nothing in the Public Utility Regulatory Policies Act, however, requires

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[13]*See Cities of Batavia v. FERC*, 672 F.2d 64, 80-83 (D.C.Cir.1982).

[14]*See id.; Wisconsin Michigan Power Co.*, 31 FPC 1445, 1455 (1964).

[15]*See* Opinion No. 142 at 13; J.A. at 709.

[16]*See Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589, 65 S.Ct. 829, 833, 89 L.Ed. 1206 (1945).

FERC to adopt the views of state rate-setting commissions when the Commission evaluates the reasonableness of rates that a utility may charge to wholesale customers.[17] Indeed, FERC has expressly held that the Commission is not bound to use the same allocation method established by the state.[18] The Coops' challenge to this aspect of FERC's order is not meritorious.

Furthermore, FERC's determination that CIPS's proposed 3-CP method was unreasonable is supported by substantial evidence in the record considered as a whole. The ALJ's Initial Decision found as matters of fact that CIPS did not have a summer peak demand that was significantly greater than its winter demand and that CIPS's system had a high level of use throughout the year.[19] The ALJ's decision is supported by his detailed study of CIPS's load characteristics and trends as well as of CIPS's scheduled maintenance.[20] FERC's adoption of the ALJ's determination that a 3-CP method would place an undue emphasis on CIPS's capacity utilization in the summer months is supported by substantial evidence in the record considered as a whole.

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[17]*See* 16 U.S.C. § 2612(b) (1982). Title I, section 102, of PURPA provides, in part:

> The requirements of this chapter do not apply to the operations of an electric utility to the extent that such operations . . . relate to sales of electric energy for purposes of resale.

Id.

[18]*See Alabama Power Co.*,8 FERC (CCH) ¶ 61,083 at 61,327 (1979).

[19]*See* Initial Decision at 5-13; J.A. at 701-09.

[20]*See* Initial Decision at 3-14; J.A. at 699-710.

B. *The CIPS's Allegedly Undue Discrimination Between Wholesale Customers*

The Federal Power Act prohibits a public utility from discriminating unduly among customers with respect to rates and service. Section 205(b) of the Federal Power Act provides:

> No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, services, or in any other respect, either as between localities or as between classes of service.[21]

The Cities contend that the separation of CIPS's wholesale customers into W-1 and W-2/W-3 categories as well as the disparity in rates charged to the separate customer classifications violate section 205(b)'s anti-discrimination mandate. FERC held that neither the customer classifications nor the rates were unduly discriminatory within the meaning of the Federal Power Act. The Cities seek review of both aspects of FERC's ruling on the discrimination issue.

1. The Customer Classifications

In upholding CIPS's W-1 (Coop) and W-2 (Cities) customer classifications, FERC stated that the Federal Power Act permits utilities to use reasonable classifications "based on differences in characteristics having cost

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[21] 16 U.S.C. § 824d(b) (1982).

of service implications."[22] FERC found cost-of-service differences between the Cities and the Coops, such as their different peaking times and their general customer profiles.[23] Furthermore, FERC noted that the separation of wholesale customers into separate municipal and cooperative groups was a widely used practice in the industry.

The Cities contend that FERC's approval of separate customer classifications for the Coops and the Cities is arbitrary and unreasonable. They claim that CIPS's classification method should be based on the specific chracteristics of individual customers. For example, the Cities argue that some of the Coops are summer-peaking customers with cost-of-service characteristics more similar to the Cities than to other Coops. CIPS's classifications, which are based on general characteristics, are unreasonable and unduly discriminatory under section 205(b) of the Federal Power Act, according to the Cities.

While classification of customers based on individual characteristics might produce more finely adjusted rates and more scientific results, FERC may properly grant the utilities reasonable latitude in setting rate classifications based on general characteristics of customer groups. As this court noted in *Alabama Electric Cooperative v. FERC*,[24] ratemaking is less a science than it is an art. Substantial deference must be given to FERC's judgment on the reasonableness of particular customer categories. Reviewing courts have upheld FERC's approval of

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[22]Opinion No. 142 at 5; J.A. at 810.

[23]The Cities' customer profile is concentrated on general service customers with heavy air conditioning loads. The Coops, by contrast, sevice mainly rural and farm customers. Opinion No. 142 at 5-6; J.A. at 810-11.

[24]684 F.2d 20, 27 (D.C.Cir.1982).

separate customer categories when those categories reflected general characteristics of customer classes with cost-of-service implications.[25] Because the Cities and the Coops have different customer profiles and load characteristics, the separation of the Cities and the Coops into W-1 and W-2/W-3 customer classifications is not unduly discriminatory.

2. The Rate Disparity

The Cities make the additional charge that the disparity between their rates and the rates charged to the Coops pursuant to the Coops' negotiated settlement with CIPS renders CIPS's rates unduly discriminatory under section 205(b). The ALJ found that there were no cost factors that warranted a departure from CIPS's historical practice of charging identical rates to the W-1 and W-2 customer classifications.[26] FERC similarly found that the rate disparity was not the product of actual cost-of-service differences between the two categories, but was solely the result of the settlement agreement between CIPS and the Coops.[27]

Despite the absence of a cost justification for the rate disparity, however, FERC held that the rate differences were not unduly discriminatory. The Commission noted that the rate difference was only temporary, because the settlement agreement which resulted in lower rates for the Coops only pertained to the 1979 rate filing by CIPS. Most of the rate difference would be eliminated by CIPS's use of a 12-CP method for the Coops' rates instead of the 3-CP method agreed upon by the Coops prior to the con-

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[25] *See, e.g., St. Michaels Utilities Commission v. FPC*, 377 F.2d 912, 916 (4th Cir.1967).

[26] Initial Decision at 45; J.A. at 741.

[27] Opinion No. 142 at 11; J.A. at 816.

tested rate filing. FERC reasoned that when a temporary difference in rates between customer categories is the result of a settlement agreement that does not involve bad faith or improper conduct, the difference is lawful, provided that there is no evidence of actual competitive harm or undue burden to a customer group.[28] It found neither improper conduct nor evidence of anti-competitive harm.

The Cities challenge FERC's opinion for three reasons. First, they allege that CIPS's advance settlement with the Coops was the product of bad faith and improper conduct. Second, the Cities contend that even if the settlement was properly negotiated, the prior settlement agreement does not legitimize the size of the particular rate diferential between the Coops and the Cities. Third, the Cities claim that FERC erred by requiring the Cities to bear the burden of showing anti-competitive effects. We find each of these contentions to be without merit.

The mere fact of a rate disparity between the Cities and the Coops does not establish unlawful rate discrimination under section 205(b) of the Federal Power Act. Rate differences may be justified and rendered lawful by "facts — cost of service or otherwise."[29] Because the preservation of private contracts within the context of a rate-setting statutory scheme promotes economic stability, the Supreme Court held, in the *Mobile* and *Sierra* cases, that statutory provisions governing public utilities' rates should be construed, when possible, as compatible with private

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[28] *See, e.g., Boroughs of Chambersburg v. FERC,* 580 F.2d 573 (D.C.Cir.1978) (per curiam).

[29] *St. Michaels Utilities Commission v. FPC,* 377 F.2d 912, 915 (4th Cir.1967). *See Towns of Alexandria v. FPC,* 555 F.2d 1020, 1027-28 & n. 41 (D.C.Cir.1977).

rate agreements.[30] Likewise, this court noted in *Town of Norwood v. FERC* that the anti-discrimination mandate of section 205(b) should not be read to obliterate the public policy supporting private rate contracts between utilities and their customers.[31] A fixed rate contract between the parties may justify a rate disparity, rendering it lawful under section 205(b).[32]

Settlement agreements between a utility and a customer, however, may not be completely analogous to fixed rate contracts. In the settlement agreement between the Coops and CIPS, the parties did not set electricity rates for specified terms of years. Instead, the Coops and CIPS agreed that the Coops would not challenge CIPS's unilateral rate filing with FERC and that CIPS would charge the Coops the settled rate until such time as CIPS made another rate filing at FERC. Nonetheless the policies articulated in *Mobile* and *Sierra* support treating a settlement agreement as a factual difference that may justify a rate disparity under section 205(b). Like fixed rate contracts, settlements promote market stability and reduce litigation over rate filings under the Federal Power Act. As FERC has noted, settlements would be severely discouraged, if not eliminated, if any resulting price disparities among customers were considered unlawfully discrimina-

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[30] *See United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 344, 76 S.Ct. 373, 380, 100 L.Ed. 373 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 76 S.Ct. 368, 100 L.Ed. 388 (1956).

[31] 587 F.2d 1306, 1310 (D.C.Cir.1978).

[32] *See Boroughs of Chambersburg v. FERC*, 580 F.2d 573, 577 (D.C.Cir.1978) (per curiam).

tory within the meaning of section 205(b).[33] When a settlement is reached in good faith, by means of proper conduct by the parties, and when the resulting rate disparity is not unduly burdensome to a customer group, a rate difference caused by a private settlement may survive the anti-discrimination mandate of section 205(b).

Rate disparities resulting from a private rate arrangement are lawful only when the agreement was reached through fair conduct and good faith by the parties.[34] The Cities attack the rate disparity here because, they claim, CIPS's settlement was a "sweetheart" deal between CIPS and the Coops, characterized by unequal notice of the proposed rate increases and unequal opportunities to negotiate with CIPS over rates.[35] The ALJ found, however, and FERC concurred that CIPS gave advance notice only to the Coops because only the Coops had secured an advance notice requirement in their contracts with CIPS. The Cities, by contrast, had neither sought nor secured an advance notice provision in their contracts with CIPS. We find no error in the Commission's finding that the advance negotiations between the Coops and CIPS which resulted in the settlement agreement were neither improper nor conducted in bad faith.

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[33] *See Delmarva Power & Light Co.*, 6 FERC (CCH) ¶ 61,084 at 61,162 (1979) (If rate settlements cannot survive the anti-discrimination mandate of the Act, "[n]o utility company could afford to risk anything less than a full and complete settlement with all its customers . . . . [I]ndividual customers would have no incentive to settle . . . ."). *See also Boroughs of Chambersburg v. FERC*, 580 F.2d 573 (D.C.Cir.1978) (per curiam).

[34] *Town of Norwood v. FERC*, 587 F.2d 1306, 1313-14 (D.C.Cir.1978).

[35] *See* Brief of Petitioner Cities of Bethany at 24-31.

We are persuaded that FERC's finding of proper conduct resulting in a settlement is supported by substantial evidence on the record considered as a whole. CIPS bore the risk that its revenues would be diminished by a FERC determination that CIPS's rate filing for the Cities, which matched the rate design settled upon in advance with the Coops, would not be found just and reasonable under the Federal Power Act. As FERC stated:

> What CIPSCO did was not so much discriminatory as it was risky. CIPSCO was free to negotiate a settlement with the cooperatives, but in doing so took the risk that separate settlement efforts with the cities would fail and that this Commission, in determining just and reasonable rates for service to the cities, would allocate costs to the cooperative service that were not reflected in the W-1 settlement rates. This in fact is what has happened.[36]

We affirm FERC's holding on this issue.

Second, the Cities claim that even if the Coops' settlement agreement warrants a rate disparity among customer categories, it does not justify the specific rate disparity here. We disagree. Under section 205(b), factual differences between customers should justify the particular rate disparity at issue in order to render a rate difference lawful.[37] As FERC noted, the rate disparity here was only temporary, because CIPS retained the right to file a new rate schedule with FERC to increase its rate of return from the Coops. Indeed, subsequent to FERC's final order in this case, CIPS proposed a unilateral rate fil-

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[36]Opinion No. 142 at 11; J.A. at 816.

[37]*See Public Service Co. of Indiana v. FERC*, 575 F.2d 1204, 1212 (7th Cir.1978).

ing to increase its W-1 (Coop) rates.[38] Nor was the size of the differential disproportionate to the factual difference of the settlement agreement. FERC's finding that the settlement agreement justifies the rate differential is not improper.

Finally, the Cities claim that FERC erred by its refusal to presume anti-competitive effects from the rate disparity in this case. FERC held that the Cities had the burden to show anti-competitive effects and that they failed to prove any competitive burden under section 205(b). On review, the Cities argue that prior FERC precedent requires that anti-competitive effects be presumed in this case.

FERC's refusal to presume anti-competitive effects in this case is not a departure from prior precedent.[39] The Cities' reliance on FERC's presumption of anti-competitive effects in a price squeeze context is misplaced. The price squeeze cases, in which anti-competitive effects are presumed to result from price discrimination, originally arose under the antitrust laws.[40] The anti-competitive danger in price squeeze situations is that a dominant utility supplier which competes with a wholesale customer in a retail market will charge such high rates to the wholesale customer that the customer can no longer compete with the utility in the retail market. When a utility competes with a wholesale customer in a retail market, FERC presumes anti-competitive effects from a rate disparity that burdens the customer-competitor.[41] In this case,

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[38] *Central Illinois Public Service Co.*, Docket No. ER83-78-000 (1983).

[39] *See, e.g., City of Frankfort, Indiana v. FERC*, 678 F.2d 699, 707 & n. 16 (7th Cir.1982).

[40] *See United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir.1945); *Cities of Batavia v. FERC*, 672 F.2d 64, 86 (D.C.Cir.1982).

[41] *See* 18 C.F.R. § 2.17 (1983). *See also Illinois Cties of Bethany v. FERC*, 670 F.2d 187, 194-200 (D.C.Cir.1981).

however, no facutal allegation has been made that CIPS, by charging different wholesale rates to the Coops and the Cities, is trying to gain a competitive advantage over the Cities in a retail market which both CIPS and the Cities occupy. Any anti-competitive danger from the rate disparity here is considerably more attenuated than is the harm in a price squeeze situation. FERC did not err by refusing to follow the rule in the price squeeze cases, which presume that anti-competitive effects will result from rate discrimination.

The general FERC rule, to which the price squeeze cases are the exception, is that anti-competitive danger must be proved in order to invalidate an otherwise reasonable rate disparity. In *Boroughs of Chambersburg v. FERC,* for example, this court stated that a rate disparity resulting from a contract entered into in good faith was not unduly discriminatory under section 205(b) "if *nothing else is demonstrated.*"[42] And in *City of Frankfort, Indiana v. FERC,* the court noted that *evidence* of competitive harm could render a rate disparity undue.[43] FERC did not deviate from precedent under section 205(b) by its ruling that anti-competitive effects should not be presumed to result from the rate disparity between the Cities and the Coops.

C. *The Casey Group Contracts*

The third major challenge to FERC's orders pertains to FERC's interpretation of contracts between CIPS and four of its municipal customers. This contract claim arose after the ALJ had issued his Initial Decision, when the cities of Casey, Flora, Greenup, and Newton (the "Casey

[42]580 F.2d at 578 (emphasis in original).

[43]678 F.2d 699, 707 & n. 16 (7th Cir.1982). *See also Southwestern Electric Power Co.*, 4 FERC (CCH) ¶ 61,330 at 61,768 (1978).

Group") filed motions with the Commission to prevent the rate increases under CIPS's unilateral rate filing from being applicable to them. The Casey Group sought a refund of all increased revenues collected from them since the effective date of CIPS's unilateral rate filing.

The contracts at issue were executed by the Casey Group cities and CIPS in 1965. The contracts were filed with the Federal Power Commission[44] and took effect on 1 September 1965. The contracts specify the applicable rates to be charged for the first ten years of the contracts and state that the rates and charges for the second ten years of the contracts' term shall be mutually agreed upon by the parties. The contracts contain the following provision:

> The term of this agreement shall be for a period of 20 years from and after the effective date hereunder; provided however, that the rates and charges for service hereinbefore set forth shall apply only during the first ten years of the period, and the rates and charges for the second ten years of the period shall be mutually agreed to by both parties subject to the approval of the regulatory body or bodies as may have jurisdiction thereof.[45]

The Casey Group cites and CIPS have not mutually agreed upon rates and charges for the second ten years of the contracts' duration. In 1975, the first of the second ten years, CIPS notified the Casey Group cities that it planned to make a unilateral rate increase filing with FERC, which filing would apply to the rates charged to the Casey Group cities. At that time the Casey Group cities did not chal-

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[44]Functions of the Federal Power Commission were transferred to the Federal Energy Regulatory Commission in 1977. *See* 42 U.S.C. § 7172(a) (Supp. V 1981).

[45]Opinion No. 142 at 13; J.A. at 818.

lenge CIPS's right to make a unilateral rate filing pursuant to the contracts, and they likewise failed to challenge CIPS's use of the statutory method of unilateral filings in subsequent years. Their first claim that their contracts precluded unilateral rate filings was made by motion to the Commission in January of 1982.

FERC found that the Casey Group contracts were fixed rate agreements for the first ten years of the contracts' term and "agreements to agree" for the second ten years.[46] It relied on general contract principles and the Uniform Commercial Code to determine the rights and obligations of the parties when they fail mutually to agree. Finding that the specific contract provision constituted an open price term, FERC followed the rule of the U.C.C. for setting prices in open price terms. Section 2-305 of the U.C.C. states that an open price shall be fixed at the "reasonable price at the time of delivery."[47] FERC determined that the "reasonable price" was the W-2 (Cities) rate established by FERC in its order. It further interpreted the contracts to prohibit rate increases by means of unilateral rate filings, and held that the rate increases could take effect prospectively only, from the date of FERC's order. It ordered CIPS to refund to the Casey Group cities the increased revenues collected from the four cities between the effective date of the unilateral filing and the date of the Commission's order.[48]

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[46]Opinion No. 142 at 15-16; J.A. at 820-21.

[47]U.C.C. § 2-305 (1972).

[48]*See* Opinion No. 142 at 18; J.A. at 823.

The Casey Group cities and CIPS each challenge different aspects of FERC's interpretation of their contracts. The Casey Group cities contend that the rates specified in the contracts for the first ten years must continue in effect during the second ten years, unless the parties mutually agree to new rates.[49] CIPS contends that the Commission erred by interpreting the contracts to prohibit CIPS from making unilateral rate filings. CIPS contests FERC's order requiring CIPS to refund the increased revenues collected by CIPS from the Casey Group cities since the effective date of the unilateral rate filing.

Under the Supreme Court's *Mobile-Sierra* doctrine, contracting parties may determine for themselves when and how existing rates may be altered, subject to FERC's power to adjust rates in the public interest.[50] The principal inquiry in rate-setting contract disputes is to divine the intent of the parties to the contract as to how rates are to be set.[51] A determination of the parties' intent must begin with a close textual analysis of the contract provision at issue.[52]

The wording of the provision here clearly distinguishes between the rates for the first ten years of the contracts and those for the second ten years. The provision states that the rates specified in the contracts are to remain in ef-

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[49]If, however, the rates for the first ten years as applied to the second ten years were so low as to affect the public interest adversely, FERC could adjust the rates under section 206, according to the Casey Group cities' interpretation of the contracts.

[50]*See City of Oglesby v. FERC*, 610 F.2d 897, 902-03 (D.C.Cir.1979).

[51]*City of Piqua, Ohio v. FERC*, 610 F.2d 950, 953-54, n.11 (D.C.Cir.1979).

[52]*See Papago Tribal Utility Authority v. FERC*, 723 F.2d 950 (D.C.Cir.1983).

fect "*only* during the first ten years."[53] The plain language of the contracts belies the Casey Group cities' position that, absent mutual agreement on rate increases, the rates specified for the years 1965-75 must continue in effect for the second ten years of the contracts. The language of the contracts makes clear that the parties did not intend to make the 1965 rates continue in effect between 1975 and 1985.

It thus becomes necessary to determine the rights and obligations of the parties under the contracts when the specified rates for the first ten years terminate and the parties fail mutually to agree on rates for the subsequent years. Rather than substituting the U.C.C.'s rule for open price terms in contracts for the sale of goods by merchants, it seems more reasonable to construe these contracts by reference to the backdrop of statutory schemes for establishing rates under the Federal Power Act. The *Mobile-Sierra* doctrine sets the principles by which we must reconcile the contracts' open rate term with the rate-setting provisions of the Federal Power Act. As this court has observed:

> [T]he *Mobile-Sierra* doctrine "is refreshingly simple: The contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."[54]

We turn now to the statutory scheme to determine what rate filings are consistent with the contracts' rate provision.

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[53]Opinion at 13; J.A. at 818 (emphasis added).

[54]*Papago Tribal Utility Authority v. FERC*, 610 F.2d 914, 929 (D.C.Cir.1980) (quoting *Richmond Power & Light v. FPC*, 481 F.2d 490, 493, *cert. denied*, 414 U.S. 1068, 94 S.Ct. 578, 38 L.Ed.2d 473 (1973)).

The Federal Power Act contains two basic methods for changing electricity rates. Under section 205, a utility may unilaterally file a rate change with FERC, which rate takes effect immediately after a sixty days' notice requirement has been satisfied. The effective date of a unilateral rate filing, however, is subject to a possible suspension of no longer than five months, if FERC orders an investigation into whether proposed rate changes are just and reasonable as required by the Act.[55] Alternatively, under section 206, FERC itself may establish the just and reasonable rate, provided that it first determines that a rate set by a public utility is unjust, unreasonable, or unduly discriminatory.[56] When FERC determines the just and rea-

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[55]Section 205, 16 U.S.C. § 824d(a), (d) & (e) (1982), provides:

(a) All rates and charges made . . . by any public utility for or in connection with the transmission or sale of electric energy . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(d) [N]o change shall be made by any public utility in any such rate . . . except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission . . . new schedules stating plainly the change or changes to be made . . . .

(e) Whenver any such new schedule is filed the Commission shall have authority . . . to enter upon a hearing concerning the lawfulness of such rate . . . and, pending such hearing and the decision thereon, the Commission . . . may suspend the operation of such schedule and defer the use of such rate . . . but not for a longer period than five months beyond the time when it would otherwise go into effect . . . .

[56]Section 206(a), 16 •U.S.C. § 824e(a) (1982) provides:

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate . . . is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall fix the same by order.

sonable rate under section 206, the established rate takes effect prospectively only from the date of the FERC's order setting the rate.[57]

We thus must decide whether the parties intended to permit CIPS to use the section 205 method of rate-setting, with its immediate effective date, or the section 206 method of rate-setting by FERC, which takes effect only after FERC issues its order setting a just and reasonable rate. The language of the contract provisions at issue here is consistent with permitting section 205 filings when the parties fail mutually to agree on rates. Open rate terms in contracts may properly be interpreted to permit a utility unilaterally to file rates under section 205.[58] Furthermore, the language in the contract providing that rates shall be agreed upon by the parties "subject to the approval of the regulatory body" is also consistent with section 205 filings. FERC's authority under section 205 to suspend and investigate rates filed under section 205 has been interpreted as the authority to "approve" rates.[59] Furthermore, FERC's tendency in recent years to require an explicit expression in private contracts of the parties' intention to permit unilateral filings under section 250 is not highly relevant to the meaning of a provision executed in 1965.[60]

Not only are the terms of the contracts consistent with a section 205 method of rate setting, but the parties' conduct

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[57] *See id.; FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353, 76 S.Ct. 368, 371, 100 L.Ed. 388 (1956); *Papago Tribal Utility Authority v. FERC*, 610 F.2d 914, 923-26 (D.C.Cir.1979).

[58] *See, e.g., Borough of Lansdale, Pa. v. FPC*, 494 F.2d 1104, 1106 n. 2 (D.C.Cir.1974).

[59] *See City of Piqua, Ohio v. FERC*, 610 F.2d 950 (D.C.Cir.1979).

[60] *See, e.g., Public Service Co. of New Mexico v. FERC*, 628 F.2d 1267, 1270 (10th Cir.1980), *cert. denied*, 451 U.S. 907, 101 S.Ct. 1974, 68 L.Ed.2d 295 (1981).

throughout the pertinent period of the contracts is probative of the parties' intent and of the fair meaning of the contracts. The parties' course of performance under a contract may give meaning to otherwise unclear contract terms.[61] In this case, rate for the Casey Group cities were etablished by CIPS's unilateral rate filings under section 205 from 1975 to early 1982 — almost seven of the second ten years of the contracts' term. During that time, the Casey Group cities did not protest CIPS's use of section 205's method of rate setting. This prolonged participation by the Casey Group cities did not protest CIPS's use of section 205's method of rate setting. This prolonged participation by the Casey Group cities and CIPS in a method of fixing rates when the parties failed mutually to agree on specific charges is highly instructive as to the fair meaning of the Casey Group contracts.

Accordingly, we hold that the contracts' rate-setting provision contemplates section 205 filings when the parties fail to agree on rates during the second ten years. Under the contracts, therefore, the W-2 rates as adjusted by FERC's opinion in this case should take effect on the effective date of CIPS's filing.

D. *Miscellaneous Cost-of-Service Issues*

The Cities make additional challenges to FERC's orders. They claim that FERC erred by summarily affirming the ALJ on certain miscellaneous cost-of-service issues without specifically addressing the Cities' arguments. The

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[61] *See, e.g., Pennzoil Co. v. FERC,* 645 F.2d 360, 389 n. 59 (5th Cir.1981), *cert. denied,* 454 U.S. 1142, 102 S.Ct. 1000, 71 L.Ed.2d 293 (1981); *Richmond Power & Light v. FPC,* 481 F.2d 490, 501 & n. 22, *cert. denied,* 414 U.S. 1068, 94 S.Ct. 578, 38 L.Ed.2d 473 (1973); WILLISTON ON CONTRACTS § 623 (3rd ed. 1961).

Cities contend that this procedure violates the Administrative Procedure Act.

The Administrative Procedure Act requires that agencies supply "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law or discretion presented on the record."[62] An agency is required to provide an explanation of the basis for its actions in order to provide a considered response to the losing party and an opportunity for intelligent review by the courts.[63] The ALJ's detailed and thorough 60-page Initial Decision sufficiently addresses the Cities' losing arguments on the miscellaneous cost-of-service issues and permits intelligent review by the court. FERC affirmed the ALJ by stating that the ALJ's decision on the miscellaneous cost-of-service issues was "reasonable, supported by the evidence, and consistent with Commission precedent and proper ratemaking principles."[64] FERC's affirmance of the ALJ's decision on each of these three issues is not improper.

We briefly discuss each of the miscellaneous issues in turn. First the Cities claim that FERC improperly adopted the ALJ's determination on working capital. The Cities advocated in the FERC proceedings that CIPS should receive a negative working capital allowance for its W-1 and W-2 rates. By contrast, CIPS sought a positive figure and the FERC staff proposed a zero working capital allowance. The ALJ noted that in a previous CIPS case FERC had authorized a zero cash working allowance, and the ALJ found that the Cities had failed to show that the previously established zero working allowance was unrea-

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[62]5 U.S.C. § 557(c)(3)A) (1982).

[63]*See Humbolt Express, Inc. v. ICC*, 567 F.2d 1134, 1137 (D.C. Cir.1977).

[64]Opinion No. 142 at 3; J.A. at 808.

sonable.[65] The ALJ reasoned that changing the working capital allowance figure would have required him to find that the existing charge was unjust, unreasonable, unduly discriminatory or preferential.[66] The ALJ held that the record was not sufficiently developed to make such a finding in order to permit the change which the Cities recommended.[67] We find nothing improper in FERC's affirmance of the ALJ's decision on this cost-of-service issue.

Second, the Cities claim that FERC erred by summarily adopting the ALJ's decision with respect to the transmission loss factor. The Cities claim that CIPS's evidence was inadequate to justify a 5% transmission loss factor. The ALJ, however, rejected the data introduced by the Cities as seriously flawed, and instead adopted CIPS's figures. The ALJ thoroughly explained his evaluation of the data in the Initial Decision.[68] FERC's summary affirmance of the ALJ's adoption of a 5% transmission loss figure is not improper.

Finally, the Cities claim that the ALJ erred in his rate-of-return determination by denying the Cities an opportunity effectively to cross-examine FERC's and CIPS's rate-of-return witnesses. This procedural error, the Cities contend, violates the Administrative Procedure Act, the due process clause of the Fifth Amendment, and FERC rules of practice.[69] The record of the hearing, however, reveals that the ALJ's limitation on the scope of cross-

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[65]Initial Decision at 14-18; J.A. at 710-14.

[66]*Cf. Public Service Commission v. FERC*, 642 F.2d 1335, 1345 (D.C.Cir.1980) (interpretation of the Natural Gas Act), *cert. denied*, 454 U.S. 880, 102 S.Ct. 362, 70 L.Ed.2d 189 (1981).

[67]Initial Decision at 18; J.A. at 714.

[68]Initial Decision at 39-41; J.A. at 735-37.

[69]5 U.S.C. § 556(d) (1982); 18 C.F.R. § 385-505 (1983).

examination of the witnesses was proper. After the Cities had conducted some questioning of the rate-of-return staff witness concerning treatises upon which the witness had not relied in his direct testimony, the ALJ ordered that the cross-examination be limited to the testimony on direct. The ALJ's ruling was well within the range of acceptable practice for conducting a hearing,[70] and it was not an abuse of his authority to make this particular determination on the admissibility of testimony.[71]

III. Conclusion

The orders under review are affirmed in their entirety except for FERC's decision on the Casey Group contracts' rate provision. We reverse that portion of the orders which permits the just and reasonable rates under the contracts to apply prospectively only from the date of FERC's order. Under the contracts, the W-2 rate as adjusted by FERC should take effect on the effective date of CIPS's filing. The case is remanded to FERC for further proceedings consistent with this opinion.

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[70] *See* McCormick on the Law of Evidence § 21 (Cleary ed. 1972).

[71] *See Second Taxing District of Norwalk v. FERC,* 683 F.2d 477, 485 (D.C.Cir.1982).

ITEM D

ORDER OF THE U.S. COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT APRIL 6, 1984

ITEM D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 82-2168, 82-2189, 82-2301

Cities of Bethany, Bushnell, Illinois, *et al.*,
Petitioner,

v.

Federal Energy Regulatory Commission,
Respondent,

Central Illinois Public Service Company,
Intervenor.

BEFORE: Wilkey and Wald, Circuit Judges, and MacKinnon, Senior Circuit Judge

April 6, 1984
ORDER

On consideration of Petitioners' Petition for Rehearing, filed March 23, 1984, it is

ORDERED by the Court that the aforesaid Petition for Rehearing is denied.

Per Curiam

For the Court:

GEORGE A. FISHER, Clerk

BY:

Robert A. Bonner
Chief Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 82-2168, 82-2189, 82-2301

Cities of Bethany, Bushnell, Illinois, *et al.*,
Petitioner,

v.

Federal Energy Regulatory Commission,
Respondent,

Central Illinois Public Service Company,
Intervenor.

Before: ROBINSON, Chief Judge; WRIGHT, TAMM, WILKEY, WALD, MIKVA, EDWARDS, GINSBURG, BORK, SCALIA and STARR, Circuit Judges, and VAN DUSEN, Senior Circuit Judge, U.S. Court of Appeals for the 3rd Circuit.

April 6, 1984

ORDER

The Suggestion for Rehearing en banc of Petitioner, filed March 23, 1984, has been circulated to the full Court and no member has requested the taking of a vote thereon. On consideration of the foregoing, it is

Ordered by the Court en banc that the aforesaid suggestion is denied.

Per Curiam

For the Court:

GEORGE A. FISHER, Clerk

BY:

Robert A. Bonner
Chief Deputy Clerk